

**Agreed-Upon Procedures Report on the  
State of New York Department of Labor's  
Year 2000 Grant Expenditures**

**FINAL REPORT**

This agreed upon procedures report was prepared by KPMG Information Risk Management 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.

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Assistant Inspector General for Audit

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## ACRONYMS

AS&T	Administrative, Staff and Technical
COP	Certificate of Participation
DOL	United States Department of Labor
ES	Employment Security
ETA	Employment and Training Administration
FM	Unemployment Insurance Field Memorandum
FY	Fiscal Year
FPY	Fiscal Program Year
IV&V	Independent Verification and Validation
LAN	Local Area Network
NYS	New York State
OIG	Office of Inspector General
ORM	Office of Regional Management
PC	Personal Computer
RA	Regional Administrator
SBR	Supplemental Budget Request
SESA	State Employment Security Agency
UI	Unemployment Insurance
UIPL	Unemployment Insurance Program Letters
Y2K	Year 2000



## EXECUTIVE SUMMARY

During Fiscal Years (FYs) 1998 and 1999, Congress appropriated funds to assist State Employment Security Agencies (SESAs) in making their automated Unemployment Insurance (UI) and Employment Security (ES) systems Year 2000 (Y2K) compliant. The U.S. Department of Labor (DOL), Employment and Training Administration (ETA) awarded the State of New York, Department of Labor (hereafter referred to as “NY,” “the State” or “the Agency”) \$14,889,355 in supplemental Federal funding for Y2K compliance activities.

A total of \$13,889,355 was received through Supplemental Budget Requests (SBRs) and \$1 million dollars was provided in FY1998 as base grant monies. Base grant funding was allocated for Y2K activities related to ES automated systems and \$180,000 for independent verification and validation (IV&V) activities. FY1998 SBR funding (including the IV&V funding) amounted to \$12,119,193. In FY1999, the Agency received additional SBR funding of \$1,770,162. The table below summarizes the Y2K supplemental Federal funding awards received by NY:

<b>Fiscal Year</b>	<b>Base Grant Awards</b>	<b>SBR Awards</b>	<b>Total</b>
<b>1998</b>	\$1,000,000	\$12,119,193	\$13,119,193
<b>1999</b>	-----	\$ 1,770,162	\$ 1,770,162
<b>Total</b>	\$1,000,000	\$13,889,355	<b>\$14,889,355</b>

The objective of this agreed-upon procedures engagement was to determine whether Y2K funds were spent for intended purposes, in conformity with the grant agreements and applicable Federal requirements. Fieldwork was performed at the Agency’s offices in Albany, NY, and remotely from KPMG offices in Washington, D.C., beginning April 23, 2001, and continued until October 11, 2001.

In addition to the \$14,889,355 awarded to NY, the State charged an additional \$1,672,435 to the Y2K grants fund ledger. KPMG received and reviewed supporting documentation for direct and allocated costs expensed as Y2K costs.

There were instances where the Agency did not adhere to ETA’s requirements governing the use of Y2K funds. We identified grant expenditures of \$3,976,331<sup>1</sup> that were not spent in accordance with Federal requirements. Costs we have questioned include:

- \$346,936 charged for work performed before grants were effective and/or work that benefited State programs;

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<sup>1</sup> In the draft report we questioned \$4,547,947. The amount questioned has been reduced by \$571,616 because of additional documentation provided by the State related to delays in back-filling positions after issuance of the draft report.

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- \$96,583 expended on extended warranty and maintenance purchases that were not necessary to ensure Y2K readiness;
- \$2,701,489 of base-funded staff costs and related allocations spent on positions that were not backfilled; and
- \$831,323 of base-funded staff costs and related allocations associated with delays in backfilling positions.

We recommend that the Assistant Secretary for Employment and Training recover a total of \$3,976,331 in improperly charged costs.

NY provided written comments to KPMG's draft report that was issued on October 11, 2001. We have included excerpts from the comments in appropriate sections of this report. In addition, this report includes conclusions reached by KPMG regarding NY's comments, as they relate to the specific findings discussed in this report. We have also included the entire text of NY's comments as an attachment to this report.

## INTRODUCTION AND PRINCIPAL CRITERIA

### Origin and Purpose of Year 2000 Funds

In FY1998, concerns with the approach of Y2K and the potential for problems with automated systems prompted Congress to provide SESAs with grants and supplemental budgetary funding requests that totaled \$205 million. The funds were provided to help ensure SESAs UI and ES systems would be Y2K compliant.

The ETA distributed base funding of \$1 million to each of the 53 SESAs. In addition to base funding of \$53 million, ETA awarded \$9,540,000 (\$180,000 to each SESA) to develop continuity or contingency plans, in the event of Y2K related shutdowns of critical UI and ES systems, or for IV&V of Y2K compliance measures. During FY 1998, each SESA was also afforded the opportunity to request additional funds for specific Y2K needs, through SBRs. The SBRs detailed specific Y2K related needs for which the funds were requested. The SBRs were evaluated by a panel consisting of ETA staff, and funds were awarded based upon what the panel judged were “reasonable and allowable” costs.

In FY 1999, ETA reprogrammed an additional \$50 million of UI contingency funds, to address the SESAs’ Y2K needs. The funds were also awarded to the SESAs through the SBR process. ETA required the SESAs to demonstrate a “compelling need” in order for the funds to be considered for the FY1999 awards.

### Y2K Funds Provided to New York State

The State of NY received \$14,889,355 in federal funding for Y2K compliance activities. A total of \$13,889,355 was based on SBRs and \$1 million was provided in FY 1998 base grant monies. Base grant funding was allocated for Y2K activities related to ES and UI automated systems and \$180,000 for IV&V. FY 1998 SBR funding amounted to \$12,119,193 (including the IV&V funding). In FY 1999, the State received additional SBR funding of \$1,770,162.

SBR funding awarded in FY 1998 expired on December 31, 2000, and FY 1999 expired on December 31, 2001. Based upon NY SESA records, as of December 31, 2000, all federal Y2K funds had been spent. As of March 31, 2001, NY had charged a total of \$16,561,790 to the federal Y2K grant fund ledgers, exceeding the amount awarded to the State by \$1,672,435.

### Principal Criteria

Guidelines for spending Y2K supplemental funds were contained in ETA Field Memoranda, the ETA Handbook, Unemployment Insurance Program Letters and the ETA Regional Monitoring Guide.

ETA Field Memorandum 50-97, dated August 4, 1997, provides the following criteria for use of FY 1998 Y2K funding:

*The Y2K Compliance projects by which funds are received must focus on activities relating to Y2K conversion efforts, the replacement or upgrading of systems, systems interfaces, and/or software products necessary to ensure Y2K compliance, or replacing or upgrading computer hardware that is not Y2K compliant and that will adversely impact system or program performance if not replaced or upgraded.*

ETA Field Memorandum 3-99, dated October 13, 1998, provides the following criteria and guidance regarding FY 1999 supplemental funding:

*The Y2K funds received must be used only for activities relating to Y2K compliance efforts including replacement or upgrading of systems, systems interfaces, and/or software products which will adversely impact system or program performance if not replaced or upgraded. . . .*

*FY 1999 funds are intended to meet those identified immediate requirements of those SESAs which, in the absence of these additional funds, are unlikely to achieve Y2K compliance of their employment security automated systems. Thus, compelling need is the primary criterion, which will be used in evaluating SBRs [Supplemental Budget Requests]. Additionally, the SESA must demonstrate that the funds will materially assist the SESA in achieving its Y2K compliance goals.*

The ETA's "The Y2K SBR Review Panel's Briefing Package" Executive Summary stated that SESAs should prioritize their spending to best meet their own critical needs, and that ETA Regional Offices should:

*. . . strongly encourage the SESAs to initially concentrate their efforts and resources on making UI Benefits systems compliant, as they are mission critical and will be the first to fail. Before funds are spent on PC upgrades and replacements, mission critical systems need to be converted and tested for compliance.*

## OBJECTIVE, SCOPE AND METHODOLOGY

The primary objective of this engagement was to determine whether funds designated for Y2K compliance were spent for intended purposes, in compliance with grant provisions and other applicable Federal criteria.

We reviewed uses made of Y2K grant and SBR funds received by the Agency, during the period of October 1, 1997 through September 30, 2000. We reviewed the SBRs and quarterly Financial Status Reports, interviewed State officials and reviewed financial records and other documentation related to Y2K conversion expenditures.

The engagement was conducted in accordance with agreed upon procedures developed by the USDOL, OIG and found in the *DOL-OIG Engagement Guide-Y2K SESA Spending* and included such tests as the OIG considered necessary to satisfy the objectives of the engagement. The agreed-upon procedures engagement was also performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Our review of internal controls was limited to those controls related to the FY 1998 and FY 1999 Y2K funds. Fieldwork began April 23, 2001 and continued into October 11, 2001.



## INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

We have performed the procedures described in the engagement program provided by the U.S. Department of Labor, Office of Inspector General (OIG), which were agreed to by the OIG, solely to assist in evaluating the State SESA's compliance with terms and provisions of the Y2K grants as noted in the Unemployment Insurance Field Memoranda (FM) and Program Letters (UIPL).

This agreed-upon procedures engagement was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards*, issued by the Comptroller General of the United States.

The sufficiency of these procedures is solely the responsibility of the OIG. Consequently, we make no representation regarding the sufficiency of the procedures described in the engagement program, either for the purpose for which this report has been requested or for any other purpose.

The results of our procedures are enumerated in the Results of Agreed-Upon Procedures section of this report.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the Agency's compliance assertion on its utilization of the funds granted by the ETA. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

**This report is intended solely for the use of the OIG and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.**

## RESULTS OF AGREED-UPON PROCEDURES

Through its remediation efforts, NY avoided interruption of UI and ES services on January 1, 2000. However, it did not always adhere to ETA's requirements governing the use of Y2K funds. We identified grant expenditures, totaling \$3,976,331 that were not spent in accordance with the Y2K grant requirements. For purposes of discussion, we have classified questioned costs into the following expenditure categories:

- \$346,936 charged for work performed before grants were effective and work that benefited State programs;
- \$96,583 expended on extended warranty and maintenance purchases that were not necessary to ensure Y2K readiness;
- \$2,701,489 of base-funded staff costs and related allocations spent on positions that were not backfilled; and
- \$831,323 of base-funded staff costs and related allocations associated with delays in backfilling positions.

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**\$346,936 CHARGED FOR WORK PERFORMED BEFORE  
GRANTS WERE EFFECTIVE AND WORK THAT BENEFITED  
STATE PROGRAMS**

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NY charged \$346,936 to the Y2K grants for contract work performed prior to the grant's start date of October 1, 1997, and for services that benefited State programs rather than UI and ES programs.

Field Memorandum 50-97, dated August 4, 1997, states, in reference to use of FY 1998 Y2K funds:

*The funds cannot be applied retroactively to work performed or to products already purchased prior to October 1, 1997, but may be applied anytime after October 1, 1997, regardless of when the appropriation is passed.*

In July 1997, NY entered into a contract with an information technology contractor for Y2K remediation services. In total, \$9,569,861 was charged to Y2K grants. We reviewed 443 invoices, representative of the entire population of invoices charged to the Y2K grants fund as reported by the State's Finance & Accounting Reporting System. During the review, we identified invoices that indicated services that partially or wholly benefited State programs and/or billing periods that were prior to October 1, 1997. In total, we determined that \$346,936,

involving 177 invoices, were charged to the Y2K grant for work performed prior to the October 1, 1997 effective date and/or for services that benefited State programs rather than UI and ES.

## **NY's Comments Regarding Work Performed Before Grants Were Effective and Work that Benefited State Programs**

NY commented:

*During the audit, KPMG requested documentation from Keane [NY's Y2K contractor] regarding the billing periods reflected on the invoices. In the Draft Report, KPMG failed to note that Keane provided a statement that the billing periods referenced on the invoices did not reflect the actual dates of the work performed, but instead reflected the entire deliverable period that the invoices covered. KPMG also failed to note that Keane's statement went on further to say that, based upon the resource hours dedicated to the project, \$293,165.00 was Keane's estimate for the cost of their services performed prior to 10/1/97. KPMG has decided to arbitrarily deem that this documentation was unacceptable and, therefore, on page seven of the draft report a total of \$346,936.00 was considered not chargeable to Y2K funding sources, based solely upon KPMG's review of the billing periods referenced on the invoices. . . .*

## **KPMG's Analysis of NY's Comments Regarding Work Performed Before Grants Were Effective and Work that Benefited State Programs**

The questioned cost of \$346,936 is the total amount of payments to Keane for services received prior to October 1, 1997 and for services that benefited State programs not off-set by Federal activities charged to the State's Certification of Payments program. In some cases, invoices included payments, which were disallowable under both scenarios.

KPMG did not arbitrarily regard Keane's statement related to the billing periods and the amount of services received prior to October 1, 1997, as unacceptable. In response to our initial request for auditable records to validate New Your State's (NYS) assertion that billing periods for some invoices were incorrect, the State obtained from Keane a brief e-mail that estimated the amount of services received prior to October 1, 1997.

Upon receipt of the e-mail, KPMG requested that NYS obtain documentation from the contractor that would reasonably support the assertion. However, after numerous requests, verifiable documentation was not provided to KPMG. As a result, KPMG reasonably and logically based its review of services received from Keane on invoices used to approve and issue contractor payments, as recorded in the agency's Financial Accounting & Reporting System (FARS). It was the individual review of each of the invoices that resulted in our decision to question \$346,936.

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**\$96,583 WAS EXPENDED ON EXTENDED WARRANTIES AND  
MAINTENANCE PURCHASES THAT WERE NOT NECESSARY TO  
ENSURE Y2K READINESS**

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KPMG analyzed source purchasing documents to assess expenditures of Federal Y2K funds. During the analysis, we identified a total of \$96,583 in Y2K Federal funds that were spent on extended warranties for hardware and annual software maintenance. The amount consists of the following items:

- \$88,953 spent on warranties for the 447 laptops; and
- \$7,630 spent on annual maintenance for Optical Card Reader (OCR) software.

The ETA's ET Handbook No. 336, 16<sup>th</sup> Edition states:

*SBR funds may not be used for ongoing costs, such as maintenance of software and hardware. . . .*

Furthermore, ETA Field Memorandum 47-99, dated July 14, 1999, addresses the use of Y2K funds for maintenance costs as follows:

*These funds may not be applied to base staff positions or to support staffing positions otherwise covered by base grants, or to on-going maintenance activities or to on-going communication costs.*

KPMG does not consider the purchase of warranties or annual software maintenance to be a compelling Y2K need. Rather, we consider the purchases to be routine and maintenance-related in nature, thus not within the spending guidelines established by ETA for Y2K funds provided through SBRs. NY has concurred with this finding.

### **NY's Comments Regarding Expenditures on Warranties and Maintenance Agreements**

New York did not provide any additional comments regarding this finding. The \$96,583 in Y2K Federal funds that were spent on extended warranties for hardware and annual software maintenance remains a questioned cost.

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**\$2,701,489 OF BASE-FUNDED STAFF COSTS AND RELATED  
ALLOCATIONS SPENT ON POSITIONS THAT WERE NOT BACK-  
FILLED**

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NY charged a total of \$3,473,865 in salaries and personnel benefits to the Y2K effort. Total personnel charges consist of \$3,038,616 in regular salary and \$435,249 in overtime costs. Based on the regular salary charges, allocations for Administrative, Staff and Technical (AS&T) costs totaling \$282,324 and allocations of equipment, supplies and communications costs totaling \$1,464,741 were also charged to the Y2K grants.

ETA recognized the potential for SESAs to incur additional salary costs during Y2K compliance activities. Therefore, ETA allowed the use of Y2K funds for overtime costs of base-funded staff and salaries for additional staff hired to work on critical Y2K-related projects incurred after October 1, 1997. However, to ensure that Y2K grant funds were not to be used to supplant the cost of base-funded staff, restrictions on how the funds could be spent were established. In Field Memorandum 50-97, dated August 4, 1997, ETA established that for FY 1998 Y2K SBR funds:

*Costs incurred by SESA base funded staff assigned to the project on a temporary basis cannot be funded by the Y2K grant; however, overtime costs are allowable. Any staff costs must be for additional staff, not previously funded by the SESA's base grant, or for overtime applied to Y2K activities performed by technical staff or program personnel.*

Also ETA Field Memorandum 47-99, dated July 14, 1999, states FY 1999 SBR funds:

*. . . may not be applied to base staff positions or to support staffing positions otherwise covered by base grants, or to on-going maintenance activities or to on-going communication costs.*

NY did not comply with the requirements specifically addressed to the use of SBR funds for regular salary costs and charged \$1,334,559 of base-funded staff salaries to the Y2K grant for positions, which were not backfilled. The amount of allocated fringe benefits associated with this amount is \$380,722. In total, NY improperly spent \$1,715,281 in regular salary and fringe benefits for positions that were not backfilled.

New York has raised the issue of whether the \$1 million base Y2K grant could be used to pay for regular staff salaries. The Agency requested that it be allowed to use the \$1 million of Y2K funds awarded with FY 1998 base funds for regular staff costs assigned to Y2K-related work. In responding to our Statement of Facts, the State of New York attached a letter dated October 9, 1997, from ETA's New York Regional Administrator (RA) which provided that, "The base grant funds may be applied to base staff if the base staff is assigned to work on Y2K activities." We have since learned that the RA's statement was verbatim from an electronic mail (e-mail) message sent by ETA's Office of Regional Management (ORM) to the RAs, on October 7, 1997,

the purpose of which was “to provide clarification to the funding requirements provided in FM 50-97. . . .” Although both the e-mail and the RA’s letter went on to require the backfilling of regular base positions redirected to Y2K activities funded by the SBR, they were silent as to whether regular base positions redirected to Y2K base grant activities needed to be backfilled. Both the ORM e-mail and the letter from the RA were disseminated outside of ETA’s formal policy-making procedures.

As interpreted by the State, the New York RA’s letter may conflict with the formal governing criteria provided in FM 50-97, which was disseminated nationally, with respect to the limitations on the use of the Y2K base grant to fund regular base staff positions. However, as the original e-mail was distributed as a clarification, rather than change, to the existing policy, and because it was silent on the issue of the need to backfill regular base positions funded with the Y2K base grant, its meaning was ambiguous at best.

The State’s interpretation also contravenes the purpose for which Y2K funds were appropriated and the intent of the restrictions. Y2K grant funds were expected to be spent on Y2K-readiness activities. DOL provides all SESAs annual appropriations to pay the costs of administering ES and UI activities, and the appropriations include monies for base-funded personal service and benefit costs. Restrictions on how Y2K funds could be spent helped ensure the grant funds were used to pay the additional costs of staff working on Y2K-related problems, and prevent Y2K funds from being used to supplant the cost of base-funded activities.

Also, NY’s stewardship of its Y2K grants causes us to question whether the State relied on the interpretation and recognized a distinction between restrictions affecting Y2K base grants and SBRs. NY commingled funds related to the Y2K base grant and SBRs in fund ledger accounts. Although New York accounted for their expenditures by fiscal year, they did not segregate the source of funds to distinguish which expenditures were charged against the separate funding sources. The majority of the expenditures charged to the commingled accounts included a contractor’s invoices, regular staff salaries, and indirect costs allocated to the activities. We are unable to determine what activities were paid for by each of the grants, and NY’s accounting practices indicate that the State did not segregate each of the grants’ funds, which should have been done to ensure unallowable base funded salary costs were not charged to the SBRs. Consequently, we continue to question \$1,715,281 in salary and fringe benefit charges to the Y2K grants.

In addition to direct salary charges and fringe benefits, NY charged to the Y2K grants a total of \$282,324 in AS&T costs that were calculated as a basis of regular salary costs. Of this amount, \$159,370 was allocated based on the \$1,715,281 in salary costs for positions that had not been backfilled. KPMG considers the \$159,370 of AS&T allocated to regular salary costs that were not backfilled to be questioned costs.

New York also allocated \$1,464,741 in equipment, supplies, and communications costs to the Y2K grant funds. Of the \$1,464,741 in allocated charges, we are questioning \$826,838 attributable to positions that were not backfilled.

## **NY's Comments Regarding the Use of Base-Funded Staff**

New York responded that they charged staff costs to the Y2K project to properly account for the Y2K costs because the staff worked specifically on Y2K. Agency officials further noted that they requested clarification from the Regional Office of the United States Department of Labor on the allowed use of these funds and that the Regional Office had approved use of the \$1 million for base-funded salary charges. New York officials stated that if ETA did go outside their policy guidelines that New York should not be penalized for following guidance provided them by the regional office. In addition, New York stated that financial activities relating to Y2K were not commingled as reported by KPMG, but that:

*Our accounting reports very clearly separated costs by project code in order to maintain separate financial activity accountability. Each project's costs were then rolled to an overall fund ledger, our program funding source, which in this instance, was Federal Y2K monies.*

## **KPMG's Analysis of NY's Comments Regarding Use of Base-Funded Staff**

As explained in the draft report, base-funded staff could only be charged to Y2K if the positions were properly backfilled. The intent of this restriction was to limit the charges incurred to additional costs associated with Y2K readiness. Staff already funded by SESA base allocations did not need to be funded again by the Y2K monies. Regardless of whether the base-funded staff was charged against the \$1 million grant or the SBRs, the effect of charging already funded staff to Y2K readiness efforts results in a windfall to base-funding. Because SESAs have bottom line authority, additional base-funded expenditures made possible by transferring base charges to Y2K are additional outlays of the Federal Government.

The report has been revised to indicate that base-funded and fiscal year SBR funds, rather than financial activities, were commingled. NYS has correctly stated that it did separate expenditures by established project codes. However, these project codes were used to record costs in accordance with the fiscal year in which expenses were incurred, not the specific source of the funds used. It is the use of an overall fund ledger discussed by NYS that is in question. The overall fund ledger consisted of commingled Y2K base and fiscal year SBR funds and did not provide a segregate account of whether awarded FY Federal funds were used for allowable SBR purposes. As a result, we were unable to determine whether unallowable base-funded salary costs were charged against SBRs.

## **NY's Comments Regarding the Allocations Related to Charges of Base-Funded Staff**

*Also, please note that the allocated costs outlined on pages eight and ten of the audit report are directly related to the disallowance of personal services costs. Consequently, when the \$1M in base grant funds and the backfilled position costs*

*are found to be allowable, a proportionate share of the related Fringe, AS&T and NPS that was disallowed should substantially be reduced.*

## **KPMG's Analysis of NY's Comments Regarding Allocations Related to Charges of Base-Funded Staff**

New York argued the \$1 million in base grant personal service costs are proper Y2K charges because the ETA regional office memorandum previously discussed sanctioned uses the State made of them. The State also argued that additional allocated charges associated with their expenditures should also be deemed allowable Y2K grant expenditures.

We do not agree that the \$1 million in base grant and backfilled staff costs is allowable. However, if the grant officer rules otherwise, the total of both direct and allocated charges to the Y2K funds should not exceed \$1 million. New York's proposal would allow it to spend not only the \$1 million, without regard to the backfill restriction, but also \$574,954 of additional allocated costs that do not satisfy Y2K requirements. KPMG believes SBR funding should not absorb allocated expenses as a result of direct costs related to the \$1 million dollar grant.

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### **\$831,323 OF BASE-FUNDED STAFF COSTS AND RELATED ALLOCATIONS ASSOCIATED WITH DELAYS IN BACK-FILLING POSITIONS**

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During fieldwork, New York provided information that the positions of 18 additional base-funded employees, involved with Y2K activities and whose costs were charged to the Y2K grants, were filled at some point during the periods the grants were effective. However, the 18 positions were backfilled over varying periods of 1 to 19 months after their costs were charged to the Y2K grants.

Because the U. S. Department of Labor already provides funding for the base positions, any salary costs charged to Y2K during the "lapse period" resulted in base-funded savings to New York. These savings were then available for use by the State to fund other activities. Consequently, we have questioned costs associated with these positions.

After issuance of the draft report<sup>2</sup> New York did provide us with requested information that has allowed us to determine costs related to the base-funded staff that worked on Y2K activities during the "lapse periods." As a result of the additional documentation, questioned costs relating to delays in backfilling positions have been reduced to \$831,323.

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<sup>2</sup> In the draft report we questioned \$1,402,939 related to delays in back-filling positions. Subsequent to the draft report, New York provided additional documentation that reduced the amount of questioned costs related to this finding to \$831,323

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The costs related to the 18 individuals are as follows:

• Salaries and Fringe Benefits	\$527,839
• AS&T Allocation	49,043
• Equipment, Supplies & Communications Allocation	254,441

NY has responded that delays in backfilling positions of base-funded staff assigned to Y2K projects was the result of an extraordinary demand for individuals with computer programming skills. The State also cited the ability of private sector employers to better compete for skilled labor by paying salaries above the State's established rates.

While KPMG does not discount that NY experienced difficulty in obtaining additional staff, we do not believe that NY complied with ETA's requirements regarding use of SBR funds for regular salary costs. Charging the salary costs and related allocations to the Y2K grants relieved the ES and UI base funded grants of these charges thus providing New York with savings for non-Y2K activities.

### **NY's Comments Regarding Delays in Backfilling Base-Funded Staff**

NY's response to our draft report reiterated its difficulty in hiring individuals with computer programming skills. During this period for the hiring of computer titles, New York noted at least a 6-month vacancy factor in filling of positions. It was critical and essential to make a management decision to shift the base staff to the Y2K project in spite of the vacancy factor or the Department would not have reached Y2K compliance.

### **KPMG's Analysis of NY's Comments Regarding Delays in Backfilling Base-Funded Staff**

On October 24, 2001, subsequent to issuing of our draft report, NYS provided additional documentation regarding the partial backfilling of regular base-funded positions. Based upon review of this documentation, the total amount of questioned salary costs in this category has been reduced from \$890,781 to \$527,839. Additionally, the amount of AS&T and allocated costs associated with remaining questioned salary costs has been proportionately reduced from \$429,394 to \$303,484. Costs that remain unallowable are those, which were spent on base-funded regular salary costs and associated allocations during periods in which positions were left vacant and not backfilled.

### **NY's General Comments Not Related to Specific Questioned Costs**

New York also addressed the following issues regarding Y2K costs in response to the draft report.

New York pointed out that the KPMG report does not dispute that Year 2000 compliance funds were utilized for their intended purposes. Further, the state asserts that the Department spent an additional \$1,672,435.00 in remediation costs that had to be funded from regular annual Unemployment Insurance base grant and \$3,320,038.00 in State funds to accomplish Federal Y2K related activities

New York also commented that the risk it took in not achieving Y2K readiness justified its failure to comply with grant restrictions:

*We note that on page four of the audit report, ETA field memorandum 3-99, dated October 13, 1998, is referenced. This memorandum provided guidance from USDOL on the activities relating to Y2K compliance, which the Department fully complied with. We replaced or upgraded our systems, system interfaces and software products which, had they not been replaced, would have adversely impacted our system operations and capabilities. Furthermore, in a previous memo dated February 10, 1998, from Raymond Uhalde, Acting Assistant Secretary of Labor, New York was informed that we had been designated as “at risk of not achieving Year 2000 compliance for mission–critical Unemployment Insurance (UI) and Employment Service (ES) automated systems.” This letter stressed the importance and critical nature of completing the Y2K conversion of New York’s automated systems in a timely manner and the agency took the actions necessary to complete these projects accurately and timely by the required due dates set by USDOL. As a result, the Department was required to use its most experienced Information Technology staff on this critical project in order to meet the required objectives, which was to achieve compliance for all of our UI and ES systems.*

Finally, the State argued that because it had successfully met the objective of Y2K readiness we should not have questioned Y2K grant charges:

*On page seven of the draft report, KPMG notes “questioned costs”, yet in fact, as detailed by the response letter discussed earlier to the Statement of Facts, all costs incurred by the Department were costs necessary in order to achieve year 2000 compliance. This is evidenced by the fact that the Department met its goals and that none of the Department’s systems failed, all claimants were paid their respective benefits, claimants were appropriately determined eligible or ineligible, and employer contribution rates and interest calculations were computed correctly. In essence, the Department complied with and accomplished the objective as set forth by USDOL for becoming Y2K compliant.*

## **KPMG's Analysis of NY's General Comments**

Concerning NY's comments that it spent Y2K funds for intended purposes, Federal funds provided NYS for remediation of its ES and UI programs were subject to spending guidelines specified in USDOL Field Memoranda, UIPLs and ETA Handbook 336. The stated objective of our review was "to determine whether Y2K funds were spent for intended purposes, in conformity with the grant agreements and applicable Federal requirements. KPMG reviewed accounting records and other documentation to determine if the State spent Federal funds within established guidelines and for the purposes for which they were requested via Supplemental Budget Requests. Agency expenditures which were not within spending guidelines, have been identified as questioned costs in our agreed upon procedures report. KPMG did not review, nor provided comment on the State funds NYSDOL expended.

NY has also commented that the risks it faced in not achieving Y2K compliance justified using based funded staff, although it violated grant requirements. NY faced risks in not achieving Y2K compliance, as did most public and private organizations. However, ETA established spending guidelines for Y2K Federal funds through issuance of numerous field memoranda, UIPLs, and the ETA Handbook 336. In accepting Federal grant monies, NYS agreed to comply with the guidelines.

In addition to field memorandum 3-99, ETA also issued field memorandum 50-97, field memorandum 47-99 and ETA Handbook 336 as noted in our report, to provide specific guidance as to how SESAs could use Federal funds. These criteria placed restrictions on the use of funds relative to regular salaries, overtime, contractor services, and ongoing maintenance costs. NYS compliance can only be attested to by its compliance with the collective issuance of ETA guidance. Expenditures determined not to be in compliance with the spending guidelines have been identified as questioned costs in this Agreed-Upon Procedures Report.

Concerning the State's comments that it had met the objective of achieving Y2K readiness, the purpose of our review was not to determine whether purchases benefited the State in achieving Y2K readiness. Rather, it was to determine if Federal Y2K funds were spent for intended purposes, in conformity with the grant agreements and applicable Federal requirements.

As we have previously discussed, NYS agreed to comply with established Federal spending guidelines and use funds for approved Y2K activities, in accepting Federal Y2K grant funds. ETA clearly indicated that not all Y2K activities could be funded with Federal grants through its Supplemental Budget Request (SBR) approval process. KPMG reviewed expenditures against Federal spending criteria and SBR award notifications and identified as questioned costs, those costs which were not in compliance.

## CONCLUSION

ETA provided significant funds to assist NY with meeting its Y2K readiness requirements. Along with funding came specific requirements governing the use of these funds. Questioned costs identified in this report should be recovered by the Assistant Secretary for Employment and Training.

## RECOMMENDATIONS

We recommend that the Assistant Secretary for Employment and Training recover a total of \$3,976,331 in improperly charged costs. These costs are categorized as follows:

- \$346,936 of charges incurred prior to the grant period and for services that did not benefit UI and ES programs
- \$96,583 expended on warranty and maintenance purchases that were not necessary to ensure Y2K readiness;
- \$2,701,489 of base-funded staff costs and related allocations spent on positions that were not backfilled; and
- \$831,323 of base-funded staff costs and related allocations associated with delays in backfilling positions.

**ATTACHMENT**



STATE OF NEW YORK  
**DEPARTMENT OF LABOR**

Administrative Finance Bureau  
Building 12  
Governor W. Averell Harriman State Office Building Campus  
Albany, New York 12240

**November 29, 2001**

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

Dear Mr. Wallace:

The following is in response to your draft report entitled, "Agreed-Upon Procedures Report on the State of New York Department of Labor (NYSDOL) Year 2000 Grant Expenditures," which discusses the audit of the Year 2000 grants that New York received from the U. S. Department of Labor. As you are aware, NYSDOL has provided a detailed response to the specific facts that were provided as potential audit findings in our letter dated August 8, 2001 (Attachment I) to the Statement of Facts Memorandum dated July 25, 2001 which I understand will be included in the official supporting documentation submitted by this agency, to be considered in your audit determination.

Y2K Cost Summary

First, we would like to note that the KPMG cover memo and the Executive Summary on page one state that, "the purpose of the audit was to determine whether the funds designated for the Year 2000 compliance were spent by the State of New York, Department of Labor for its intended purposes...." We wish to emphasize that the KPMG report does not dispute that Year

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Information Risk Management  
Washington, DC

2000 compliance funds were utilized for their intended purposes. Furthermore, NYSDOL emphatically states that all funds spent and charged to the Y2K project code were properly charged for work performed on achieving Y2K compliance. We also would like to highlight that the Department fully expended the \$1,000,000.00 that was identified specifically for Y2K purposes in the Federal 1998 Base Grant and the \$13,889,355.00 from the SBRs on Y2K remediation activities. In addition, the Department spent an additional \$1,672,435.00 in remediation costs that had to be funded from our regular annual Unemployment Insurance base grant. The Department also expended \$3,320,038.00 in State funds to accomplish Federal Y2K related activities. The additional resources were utilized to purchase many items that were considered Y2K-critical procurements needed in order to ensure full remediation; however, there was insufficient Federal funding provided to NYS to obtain all of these required items.

### **Y2K Compliance At Risk**

We note that on page four of the audit report, ETA field memorandum 3-99, dated October 13, 1998, is referenced. This memorandum provided guidance from USDOL on the activities relating to Y2K compliance, which the Department fully complied with. We replaced or upgraded our systems, system interfaces and software products which, had they not been replaced, would have adversely impacted our system operations and capabilities. Furthermore, in a previous memo dated February 10, 1998, from Raymond Uhalde, Acting Assistant Secretary of Labor, New York was informed that we had been designated as “at risk of not achieving Year 2000 compliance for mission-critical Unemployment Insurance (UI) and Employment Service (ES) automated systems.” This letter stressed the importance and critical nature of completing the Y2K conversion of New York’s automated systems in a timely manner and the agency took the actions necessary to complete these projects accurately and timely by the required due dates set by USDOL. As a result, the Department was required to use its most experienced Information Technology staff on this critical project in order to meet the required objectives, which was to achieve compliance for all of our UI and ES systems.

### **Questioned Costs**

On page seven of the draft report, KPMG notes “questioned costs”, yet in fact, as detailed by the response letter discussed earlier to the Statement of Facts, all costs incurred by the Department were costs necessary in order to achieve year 2000 compliance. This is evidenced by the fact that the Department met its goals and that none of the Department’s systems failed, all claimants were paid their respective benefits, claimants were appropriately determined eligible or ineligible, and employer contribution rates and interest calculations were computed correctly. In essence, the Department complied with and accomplished the objective as set forth by USDOL for becoming Y2K compliant.

### **Questioned Costs Documentation**

During the audit, KPMG requested documentation from Keane regarding the billing periods reflected on the invoices. In the Draft Report, KPMG failed to note that Keane provided a statement that the billing periods referenced on the invoices did not reflect the actual dates of the work performed, but instead reflected the entire deliverable period that the invoices covered. KPMG also failed to note that Keane’s statement went on further to say that, based upon the

resource hours dedicated to the project, \$293,165.00 was Keane's estimate for the cost of their services performed prior to 10/1/97. KPMG has decided to arbitrarily deem that this documentation was unacceptable and, therefore, on page seven of the draft report a total of \$346,936.00 was considered not chargeable to Y2K funding sources, based solely upon KPMG's review of the billing periods referenced on the invoices.

### **Staff Costs**

KPMG noted on page nine of the draft audit report that ETA placed restrictions on how the Y2K funds were to be spent by issuing field memorandums 50-97 and 47-99. NYSDOL had various staff working specifically on our Y2K-critical systems and therefore, the costs incurred in our Y2K ledgers were direct staff charges resulting from performing direct Y2K activities. For that reason, it was appropriate to charge Y2K for these activities. In addition, the purpose of tracking these expenditures in the Y2K ledgers was to clearly distinguish Y2K costs from our base-funded costs in the event that additional Y2K funding became available. It was clear that these staff were incurring costs associated with Y2K and our intention was to maintain the necessary proper accountability. It would not have been fiscally prudent to record these costs against base grant funds in the first instance, as the activities were directly identifiable as Y2K-related costs.

Further, in October 1997, New York received \$1 million in FY1998 base grant monies and requested clarification from the Regional Office of the United States Department of Labor (USDOL) on the allowed use of these funds. Specifically, we inquired if they could be utilized to fund base staff that were assigned to and working on Y2K projects. We received a letter (Attachment II) dated October 9, 1997 from Marilyn K. Shea, the Regional Administrator (RA) stating in paragraph two that "The base grant funds may be applied to base staff if the base staff is assigned to work on Y2K activities." Based on this direction provided by USDOL, base staff positions in our Data Processing Information Systems organization were directly assigned to the Y2K project. The SBR guidelines were specific to the SBR funds only, not the base grant funds allocated in the FY 1998 base grant. The letter also clarified that SBR funding could be used for base staff that was back-filled and New York did back-fill these positions as explained later in this memo. Nevertheless, KPMG's Draft Report infers, on page nine, that the letter from the RA was disseminated outside of ETA's formal policy-making procedures and therefore was unacceptable. Again, it appears that KPMG arbitrarily made its own conclusion on ETA's formal policy guideline without referencing any supporting documentation from ETA stating that they agree with this position. In fact, if that is the correct interpretation, that ETA did go outside their policy guidelines and since we are mandated to follow ETA's policy guidelines, KPMG should note in the audit that USDOL provided incorrect policy guidance. If this is the case, USDOL should be cited and NYSDOL should not be subject to the \$1 million disallowance for the base fund expenditures. Therefore, our position is clear and remains unchanged that we acted upon official clarification from our RA, and abided by the instructions in their further clarification of this policy.

### **Staff Costs: Concerns over Auditor Understanding**

It is clear from KPMG's Draft Report that they did not have a clear understanding of our Federal accounting reports. On page ten of the report, KPMG states that NYSDOL commingled

financial activities. This statement is totally inaccurate. Our accounting reports very clearly separated costs by project code in order to maintain separate financial activity accountability. Each project's costs were then rolled to an overall fund ledger, our program funding source, which in this instance, was Federal Y2K monies. We also reconciled the fund ledgers to our Federal financial reports, SF269, which were submitted to ETA on a quarterly basis. There was no commingling. We believe that KPMG did not understand that one funding source could support personal services, non-personal services and allocated costs as they note this as an issue in their report. We provided KPMG with all of our GA-17 reports and our SF269 quarterly Federal financial reports which supported these costs. This complied with USDOL instructions for reporting the Y2K expenditures. Note that these reports have been accepted by USDOL, indicating that the proper reporting structure was adhered to as should be expected since we have Federal approval for our nationally recognized financial accounting and reporting system. We spent numerous hours with KPMG staff reconciling these reports and were able to reconcile all reported costs.

### **Staff Costs: Information Technology Hiring Dilemma**

During the audit, NYSDOL responded to KPMG's inquiry on the back filling of base-funded staff assigned to Y2K projects. We advised KPMG that the delay was a result of an extraordinary demand for individuals with computer programming skills in both the public and private sectors. These delays *still* occurred in spite of the fact that the NYS Civil Service System, due to a statewide shortage, relaxed their criteria for filling programmer titles. Previously, these titles required an exam and a two-year traineeship to attain the full salary of the position. The criteria for filling this mission critical position was changed on April 30, 1998 to an evaluation of experience and education and the starting salary was changed to the full title starting salary. While these changes proved helpful, we continued to suffer hiring lags due to the overall shortage of programmers in the labor pool and the ability of private sector employers to compete by paying premiums above our established pay rates. While we regularly experience vacancy rates due to the administrative time it takes to engage new hires, this situation was exacerbated by a tight labor market; a situation that was completely beyond our control. In normal hiring conditions, there is a vacancy factor of about eight weeks in order to properly follow the NYS Civil Service rules and regulations. During this period for the hiring of computer titles, there was at least a six month vacancy factor in filling of positions. We provided KPMG with documentation that detailed the positions shifted to Y2K projects and the back-fills and new hires. When the positions were filled, the new hires/back-fills were assigned the normal program workload which had not been done during the period that the previous individuals were re-assigned to Y2K. KPMG did not accept this documentation as being sufficient to support the lag in back-filling our computer programming items and noted this as a questioned costs on page eleven of its report. It was critical and essential to make a management decision to shift the base staff to the Y2K project in spite of the vacancy factor or the Department would not have reached Y2K compliance.

Furthermore, we feel it is very important to stress that due to the "at risk" designation that had been assigned to New York, we found it imperative to have our experienced, permanent IT staff working on the Y2K remediation and not be put at risk of non-compliance with Y2K while



awaiting the back-filling of items. It is also important to note that while our Y2K remediation was ongoing, we sacrificed many of our base grant activities and that they had to be put on hold. NYSDOL simply did not have sufficient computer programming staff to complete both our regular on-going and Y2K tasks. As a result, we had no other choice, but to have our computer programming base staff perform Y2K remediation on our UI and ES systems.

**Staff Costs: Allocated Costs**

Also, please note that the allocated costs outlined on pages eight and ten of the audit report are directly related to the disallowance of personal services costs. Consequently, when the \$1M in base grant funds and the back-filled position costs are found to be allowable, a proportionate share of the related Fringe, AS&T and NPS that was disallowed should substantially be reduced.

**Conclusion**

Finally, as mentioned earlier, we note that New York utilized \$3,320,038 in direct State funds to pay for a portion of the Federal share of costs for Y2K. Since these were totally state funds, the federal regulations for the back-filling of positions did not apply for the usage of these funds. Therefore, we recommend that this funding be used to offset any questioned costs that may occur.

In closing, we maintain that we took the necessary management steps required to achieve a successful Y2K remediation thereby upholding the intent of the Federal Y2K-remediation directives.

Sincerely,

Lewis D Stein  
Director of Finance

Attachments

cc: M. Shea