

Oklahoma Employment Security Commission



Jon Brock, Executive Director

Frank Keating, Governor

Representing Employers
George Olla, Jr., Commissioner
Ted Weber, Commissioner

Representing the Public
Rev. W. B. Parker, Chairman

Representing Employees
David Hill, Commissioner
DeWayne Goodman, Commissioner

February 27, 2002

John F. Riggs
Regional Inspector General for Audit
525 Griffin St., Room 415
Dallas, TX 75202

Dear Mr. Riggs:

We appreciate the opportunity to respond to the draft Financial-Related and Performance Audit of the Industrial Exchange, Inc., Governor's 15 Percent Welfare-to-Work Discretionary Funds Program December 16, 1998, through June 30, 2001. As you are aware, OESC monitors first reported the major issues addressed in the draft Audit Report. Since then, the Oklahoma State Auditor and Inspector (SA&I) performed additional work in this area and confirmed our monitor's findings. We have retained the SA&I to conduct a special follow-up audit for the purpose of determining that all Welfare-to-Work funds were spent in accordance with federal and contract requirements.

While we welcome and appreciate the hard work of the OIG auditors, we strongly disagree with their conclusion and believe their recommendations are unreasonable. For example you state that:

1. "THA circumvented required procurement procedures in order to select IndEx as a WtW service provider at the direction of the Oklahoma Office of Employment Security (OESC)."
 - Your auditors relied exclusively on an untrue statement by Tulsa Housing Authority (THA) to the SA&I without corroborating evidence or giving OESC an opportunity to verify if the information was true.
 - Given the unique aspects of the IndEx project, as indicated in news stories and national publications, Oklahoma's Central Purchasing Act allowed OESC to contract directly with IndEx if that was our intent. OESC's goal was to replicate the IndEx project.

2. "OESC received its direction from the Governor's office."
 - The OIG auditors arrived at this conclusion without any evidence whatsoever. Neither the Governor of Oklahoma, nor anyone on his staff, directed OESC to give money to IndEx, Inc. Clifton Scott, the State Auditor and Inspector, has concluded that there is no evidence the Governor directed OESC to give money to IndEx, Inc.
3. The OIG auditor's recommendation that "the Assistant Secretary for Employment and Training disallow questionable costs of \$561,649 for IndEx's dismal performance outcomes and their mismanagement, waste, and abuse of WtW funds and for THA's procurement of services from IndEx without competition" is unreasonable.
 - According to Generally Accepted Auditing Standards, questioned costs generally include unallowable cost, undocumented cost, unapproved costs, and unreasonable cost. OESC agrees that some cost will likely be disallowed, however we disagree with the draft Audit Report's recommendation to question all costs. The draft Audit Report clearly states that there were some participants served by the program. And while a case is made that many expenditures are unreasonable or undocumented, we believe it is OIG's responsibility to identify specific questioned costs, not to lump all expenditures together and claim poor performance. At a minimum, cost should be allowed for those participants that were served.
4. Furthermore, the draft Audit Report's recommendation for the Assistant Secretary to direct OESC to carryout its grant management responsibilities because of findings at IndEx are not warranted.
 - We believe that our grant management activities were effective in bringing these issues to the forefront.
5. In addition, we believe the audit process for this engagement has been contrary to Generally Accepted Auditing Standards and Government Auditing Standards and are not consistent with OIG's own published procedures. OIG auditors used uncorroborated evidence as fact and did not allow us full participation in the process.

Our intent and the Governor's intent have always been to replicate the IndEx project. Despite the impression created by the draft Audit Report, at least at one time, the IndEx project was worthy of replication. We are surprised and extremely disappointed, given IndEx's prior public reputation, in the poor performance documented by the OIG as it relates to the THA contracts.

The OIG auditing process

The OIG auditing process used is not consistent with the OIG's stated processes or the process explained to us during the initial entrance conference with OIG auditors. Our concern is that the process being used is not conducive to ensuring that accurate audit findings are presented or that audit recommendations are reasonable.

According to the on-site OIG auditors during their entrance conference here at the Oklahoma Employment Security Commission (OESC) on May 1, 2001, Industrial Exchange, Inc. (IndEx), a subrecipient of the Tulsa Housing Authority (THA), was being audited, not OESC; that OESC would have an opportunity to comment on the draft audit report; and that OESC would be expected to resolve any findings. Further, an exit conference would be held with OESC to discuss potential findings, conclusions and recommendations. Then OIG would draft their audit report and offer OESC an opportunity to respond.

Below is an excerpt from OIG's official web site concerning their audit report process:

Before the audit report is issued, an exit conference is held to communicate audit results to appropriate program or agency management and to obtain the auditee's management comments on proposed findings and recommendations. Management's input is important to ensure that the audit results are fairly presented, audit recommendations are reasonable and feasible, and any errors or misrepresentations are corrected. Following the exit conference, a draft report will normally be issued to the appropriate assistant secretary, with a request that management provide written comments on the facts, conclusions, and each recommendation presented in the report within 30 days. (Emphasis added.)

These procedures were not followed during this audit. The exit conference was not held prior to issuance of the draft report as described by the OIG. The exit conference was held after the draft report was issued and was not used to "ensure that the audit results are fairly presented, audit recommendations are reasonable and feasible, and any errors or misrepresentation are corrected." In fact, the on-site OIG auditors indicated they would make no changes in their draft report based on issues discussed in the exit conference.

Additionally, we are being required to respond during the same timeframe Tulsa Housing Authority (THA) is being asked to respond. (THA now apparently operates the IndEx project.) Therefore, we have not been given an opportunity to review THA's possible response to the draft audit findings. Such an omission is one more reason we are concerned about the process and its impact on factuality, reasonableness, and fairness.

Was IndEx worthy of replication?

Despite the impression created by the draft Audit Report, at least at one time, the IndEx project was worthy of replication. According to a White Paper on WtW originally issued by Secretary of Labor Alexis Herman in October 1997, "*placing the hardest-to-serve welfare recipients in jobs will require not only commitment but innovation.*" "*States, localities and service providers should take advantage of demonstration experience and the research and evaluation findings available on how to serve this target group.*"

In September 1997, approximately a year prior to OESC's contract with THA and other entities to **replicate** the IndEx project, the Manpower Demonstration Research Corporation (MDCR) published *Tulsa's IndEx Program: A Business-Led Initiative for Welfare Reform and Economic*

Development by Maria L. Buck. MDRC is a nationally recognized, nonprofit social policy research organization.

MDRC has launched the Connections to Work project with support from the Rockefeller Foundation and the Charles Stewart Mott Foundation. One objective is to identify promising practices through a series of case studies focused on communities at the forefront of developing innovative approaches to connecting welfare recipients with jobs.

The first in this series of case studies, supported by the Charles Stewart Mott Foundation profiles the IndEx program in Tulsa, Oklahoma.

The scale of programs similar to IndEx is likely to be small, but these programs have the potential for **replication**.

Financing the Expansion (1996-1997)

The programmatic expansion was made possible in large part by the general support grant of \$200,000 from the Charles Stewart Mott Foundation. The Foundation had recently created an initiative to identify and support innovative welfare-to-work programs that utilized a demand-driven approach and were focused on involving the business community. The grant placed IndEx on a secure financial footing.

In addition, the development of IndEx II brought a new influx of finances and resources to the program. Sponsored by the Oklahoma Departments of Education, Vocational and Technical Education, and Oklahoma's Office of Juvenile Affairs, IndEx received a \$150,000 start-up grant as well as in-kind resources from the Tulsa Public Schools and the Literacy Coalition of Tulsa. Overall, the Mott award and IndEx II funds increased the annual operating budget to \$500,000, up from \$140,000 in 1995.

Both of these enhancements led to increased placement rates: more IndEx participants were placed in jobs in 1996 than in all the previous years combined. Of the 286 participants enrolled in IndEx in 1996, 110 found employment and 76 remained enrolled in the program at the beginning of 1997.

By that time, IndEx had gained recognition both within Oklahoma and across the nation as an innovative business-led approach to welfare-to-work programs.

Likewise, there were also a number of news articles touting the virtues of the IndEx project. It was reported by Scott Cooper in the April 16, 1997 **Tulsa World** that

"One of Oklahoma's best welfare-to-work programs moved its business location downtown..." "Rowley said the IndEx program is popular throughout the country. Several times a year, he travels throughout the nation to meet with business leaders, chamber of commerce officials and state lawmakers."

Becky Tierman reported in the **Tulsa World** on May 28, 1997,

"We did not design IndEx as the result of federally mandated welfare reform programs, said George Singer, chairman of the chamber board. We did it because we wanted to. It's a proactive movement."

"Last Tuesday, I spent the day at the White House explaining the program, said Wayne Rowley, director of human resource development for the chamber. They asked, How do you get the community to support for such a program."

"Upon request of those states, he has spoken to members of state government in Connecticut, Pennsylvania, California and New York about Career Partners Inc., the chamber's school-to-work initiative, IndEx I and IndEx II."

Tulsa World Editorial, Program Breaks Welfare Chain, June 15, 1997.

"Tulsa's growing welfare-to-work program, which is winning national praise, takes on even more significance in light of welfare reform legislation that is fast becoming a reality."

"IndEx is quickly proving itself to be one of the most successful welfare-to-work programs in the country."

"Tulsa is lucky to have both business leaders and civic leaders who not only see the problem, but find the solution."

And Tom Jackson wrote in the **Lawton Constitution** on April 20, 1998

"LINC, or Linking Individuals to New Careers, is a welfare to work program, explained LINC program coordinator Krystal Brue.

Brue said she is interested in the IndEx or Industrial Exchange program in Tulsa run by the Metropolitan Tulsa Chamber of Commerce, which provides training, education and work experience in cooperation with industry for people seeking to get off welfare or escape deadend jobs.

The school is investigating that and would like to start something like that here, Brue said.

(Rep.) Deutschendorf said he's studied the Tulsa program and would love to see it replicated in Lawton."

In addition, the State Chamber sponsored a meeting on November 10, 1997 to discuss **replication** strategies for the IndEx program with representatives from several communities. Leading the discussion were Narcisa A. Polonio of Replication & Program Strategies, Inc., Mark Elliott of Public/Private Ventures, and Jennifer Phillips of the Charles Stewart Mott Foundation.

This is the context in which the decision was made to attempt replication of the IndEx program.

WtW performance requirements

It is also important to understand the difficult population being served by the Welfare-to-Work program and that the U.S. Department of Labor has not issued performance requirements. According to a White Paper on WtW originally issued by Secretary of Labor Alexis Herman in October 1997,

“... a Welfare-to-Work Grant initiative that will provide needed resources for States and localities to create job opportunities for the **hardest-to-employ** welfare recipients.”

“The key objective of welfare reform is to break the cycle of dependency by promoting responsibility and work.”

“Aiding the hardest-to-employ welfare recipients in finding sustained unsubsidized employment is a **formidable challenge** – one that requires a broad-based coordinated response that utilizes the resources of federal, State and local governments, private employers and other interested organizations.”

Neither USDOL nor the State of Oklahoma has issued WtW performance requirements. USDOL has established, but not required, a Government Performance and Results Act (GPRA) goal for retention of those WtW participants placed in unsubsidized employment. (60% will remain in the workforce for 2 quarters following the placement quarter)

Performance snapshots vary depending on when the snapshot is taken. Because of the original, onerous WtW eligibility requirements and the 70%/30% expenditure requirement, grant recipients nationwide enrolled few participants and overall expenditures were exceptionally low (but extremely high per participant). As a result, Congress modified WtW requirements to expand the eligible population and significantly changed the 70%/30% requirement. Ever since these modifications were implemented in October 2000, enrollments have gone up and expenditures per participant have gone down as over time grant recipients have significantly increased enrollments while still having the same amount of grant funds to expend.

However, Tulsa Housing Authority was not able to increase their enrollments and reduce their cost per participant since OESC stopped THA's ability to enroll customers on February 2, 2001, just 4 months after loosened eligibility requirements were implemented. (This was done due to serious concerns about potential inappropriate expenditures.) As a result, THA was unable to reduce their cost per participant over time as other grant recipients did. For example, in December of 2000, Oklahoma's cost per participant for all WtW funds expended was over \$14,000. As of December 2001, the cost per participant for all WtW funds expended in Oklahoma was approximately \$4,000.

Despite the difficulty of the program and the lack of WtW performance requirements, we are surprised and extremely disappointed, given IndEx's prior public reputation, in the poor performance documented by the OIG as it relates to the THA contracts.

“Finding #1. THA did not follow procurement procedures in order to select IndEx as a WtW service provider; consequently, THA contracted with an organization not financially solvent or proven successful enough to administer Federal grant funds.”

We do not take issue with the assertion that THA failed to follow required procurement procedures. However, we do disagree with the OIG discussion and inferences accompanying this finding.

“OESC staff informed THA staff the Governor had instructed that such funds be directly awarded from THA to IndEx, Inc....”

Not only is the OIG assertion untrue, there is not a reasonable basis for making this accusation.

Both Generally Accepted Auditing Standards (GAAS) and Government Auditing Standards (GAS) address the issue of evidential matter. Both standards require that sufficient, competent, and relevant evidence be obtained to afford a reasonable basis for the auditors' findings and conclusions. Further GAAS states the auditor should obtain corroborating evidential matter by:

- Inspecting documents;
- Obtaining confirmations and other written representations from people within and outside the entity;
- Inquiring of client personnel and management; and
- Developing or reviewing pertinent information which permits the auditor to reach conclusions through valid reasoning.

The OIG auditors never requested any information from OESC to support or disprove the allegations made against us in the draft report. We were provided with a copy of the Statement of Facts issued to THA, but were told by on-site OIG auditors that no response was expected from OESC. In order to “ensure that the audit results are fairly presented, audit recommendations are reasonable and feasible, and any errors or misrepresentations are corrected”, OESC’s management should have been questioned regarding the allegations by THA and given an opportunity to respond prior to issuing the initial Statement of Facts as well as the draft Audit Report.

In addition to reviewing THA’s comment to the State Auditor and Inspector (SA&I) draft report, THA’s responses to OESC’s monitoring report should have also been reviewed. THA’s statement alone does not provide sufficient evidential matter in accordance with GAAS or GAS. Review of both reveals a direct contradiction; thus, questioning its reliance and sufficiency as evidential matter. After review by the SA&I they agree and it is our understanding that they will not include this statement in their final report.

Not only is there no legitimate basis for making this accusation, it is untrue. THA is apparently the only entity that believed OESC, at the Governor’s direction, wanted WtW 15% funds given to IndEx. When THA originally responded to OESC on July 20, 2000, concerning an OESC monitoring finding that questioned the entire IndEx contract amount, THA indicated that they entered into a sole source contract with IndEx because of the OESC contract language. (“WtW

grant funds are being provided for the purpose of **replicating** the IndEx Program in Tulsa.”) Yet when THA responded on June 14, 2001, to a similar finding by the SA&I, THA’s complete response was that they were informed on October 15, 1998, during an OESC training session, that OESC staff indicated that the Governor instructed that such funds be directly awarded to IndEx. OESC did not make such a statement and none of the other training participants had this understanding. OESC cannot state what THA believed, but we are certain that our actions were not responsible for that belief.

Likewise, the Office of Juvenile Affairs entered into similar WtW 15% funded contracts with THA and other entities yet none of the other entities provided WtW funds to Wayne Rowley or the IndEx project.

According to the OMB Circulars, the test for contracting with a sole source without competition includes: the material, product or service is available only from a single source, or the provider has a one of a kind capacity to make it available. Given the unique aspects of the IndEx project, as indicated in news stories and national publications, Oklahoma’s Central Purchasing Act allowed OESC to contract directly with IndEx if that was our intent.

In addition, the Governor, nor anyone on his staff, instructed OESC to provide WtW or any other funds to the IndEx project. According to the Sept. 18, 2001 edition of the Capitol Network News, Clifton Scott, the State Auditor and Inspector, in discussing the current WtW Special Audit,

“said that despite a letter from Governor Frank Keating promoting IndEx as a company to participate in the program, he found no evidence that the Governor intended for the money to be used in a wrongful manner.” “As far as any evidence where the Governor stiff-armed the Employment Security and said they have to have this contract, we didn’t see any evidence, Scott said.”

“IndEx also did not have a record of past success as a service provider.”

The draft Audit Report quotes the Manpower Demonstration Research Corporation publication previously cited as indicating IndEx was unsuccessful. Unfortunately, the quote used by the OIG was taken out of context. In fact, as should be obvious from the earlier quotes from the MDRC report, the purpose of the document was to share IndEx as a project worthy of **replication** nationwide. Here is the entire statement quoted in the OIG Audit Report from *Tulsa’s IndEx Program: A Business-Led Initiative for Welfare Reform and Economic Development*

TAKING STOCK

Unfortunately, **no reliable data are available on the rate of job placements or on retention in unsubsidized work, which would provide a measure of IndEx’s overall success.** We do know, however, that over the years, IndEx has done increasingly more to address the needs of its participants, including providing transportation and child care assistance, developing the financial incentives with the 30- and 60-day training programs, and establishing post-placement services for participants in the training programs.

“...IndEx did not have experience with Federal programs before receiving the WtW funds.”

Since OESC did not contract with IndEx, we are unaware of whether IndEx had experience with federal funds, but we do not understand such experience to be a criterion for being eligible for grant funding. Otherwise, only those entities already receiving federal funds would be able to receive these funds in the future.

Additional findings

We are unable to respond to the remaining findings. We have contracted with the State Auditor and Inspector's office to conduct a Special Audit of all WtW programs to determine any problems, including those previously raised by our monitors and the State Auditor concerning THA/IndEx. The SA&I has yet to issue their Special Audit Report. And as previously indicated, we have not been given an opportunity to review THA's possible response to the OIG draft Audit Report before this response is required to be submitted.

OIG draft Audit Report Executive Summary

We take strong exception to the draft Audit Report's Executive Summary. Rather than summarizing the findings, the auditor has expanded on the unsubstantiated statements to create even more inflammatory statements.

“THA circumvented required procurement procedures in order to select IndEx as a WtW service provider at the direction of the Oklahoma Office of Employment Security [sic] (OESC).”

The OIG has moved from inappropriate, unsubstantiated statements and inferences to irresponsible assertions. There is no basis in the draft Audit Report for this statement and it is untrue. This is clearly in violation of Generally Accepted Auditing Standards.

“OESC received its direction from the Governor's office.”

While this statement is not in itself untrue, its placement following the accusation that OESC directed THA to circumvent procurement practices is obviously designed to imply that the Governor's office directed OESC to have THA violate procurement procedures. This is again untrue and the OIG has again violated acceptable auditing standards. There appears to be no legitimate purpose to such an unfounded statement.

“IndEx failed to come close to meeting their contract performance goals ...”

The OIG auditors have mischaracterized a planning summary with a performance requirement. Neither the contract between OESC and THA nor the contract between THA and IndEx were performance-based contracts. I.e., neither contract based contract payments on specific performance results. While it would appear that IndEx did not achieve the anticipated service

levels stated in their planning summary; those service levels were merely planning estimates, not contractual requirements. And as previously discussed, there are no state or federal performance requirements for WtW grant recipients.

“We recommend the Assistant Secretary for Employment and Training disallow questionable costs of \$561,649 for IndEx’s dismal performance outcomes ...”

According to Generally Accepted Auditing Standards, questioned costs generally include unallowable cost, undocumented cost, unapproved costs, and unreasonable cost. OESC agrees that some cost will likely be disallowed; however we disagree with the OIG’s recommendation to question all costs. The OIG clearly states that there were some participants served by the program. And while a case is made that many expenditures are unreasonable or undocumented, we believe it is OIG’s responsibility to identify specific questioned costs, not to lump all expenditures together and claim poor performance. At a minimum, cost should be allowed for those participants that were served.

“Furthermore, we recommend the Assistant Secretary direct the State to ensure:

- **Contractors and subcontractors adhere to Federal and State regulations in procuring services from providers.**
- **Service providers are adequately monitored.**
- **Service providers use an appropriate method of allocating costs.**
- **Service providers maintain adequate documentation to support allocation of cost to WtW programs.**
- **Service providers maintain an adequate time distribution system that reflects the actual activity of employees.**
- **Service providers properly account for program income.”**

We are puzzled by these recommendations. The OIG did not audit OESC yet these recommendations indicate that OESC is not conducting its grant oversight duties.

In the OIG’s draft audit Objectives, Scope, and Methodology section the OIG indicates that they *“also reviewed OESC’s monitoring reports. Since problems noted in the monitoring reports and auditor’s working papers were extensive, ...”*

According to the State Auditor and Inspector in his December 12, 2000 WtW Special Audit Report

“We commend the (OESC) monitors efforts and accomplishments in conducting the Financial and Programmatic Reviews of OJA and THA. Many of our findings originated with findings from OESC Monitoring Reviews.”

Again, according to the SA&I’s Special Audit Report,

“The following are some of the findings included in the Financial and Programmatic Review of THA:

- Competitive bidding process not followed ...
- There were no participant files ...
- There were no records maintained ...”

It would appear that OESC is at least adequately monitoring our grant recipients.

The SA&I’s Special Audit Report detailed a number of suggested improvements to OESC’s grant oversight activities. OESC agreed with the State Auditor concerning these deficiencies and proceeded to correct them.

In response to the previous findings by OESC monitors and the State Auditor’s Office, OESC engaged the State Auditor to expand their Special Audit to all WtW grant recipients. While that Special Audit Report has yet to be presented, based on the draft findings submitted to OESC, no other grant recipient is exhibiting the problems identified at the Tulsa Housing Authority.

We would like to reiterate that the OIG did not audit OESC, nor did OESC contract with IndEx. For the OIG to assume that OESC is not carrying out its grant management responsibilities solely because of findings at IndEx seems unreasonable.

We are concerned that this draft Audit Report and the process used to develop it is not an attempt to represent fair, reasonable, or accurate results. Our intention is to work with the U.S. Department of Labor, our federal funding source for WtW funds, to determine whether any questioned costs should be disallowed. We are committed to ensuring that any disallowed expenditures, as determined by USDOL, are recovered.

Sincerely,



Jon Brock
Executive Director

John J. Getek, Deputy Inspector General for Audit
Emily Stover DeRocco, Assistant Secretary
Joseph Juarez, ETA Regional Administrator
Roy Hancock, THA Executive Director
Clifton Scott, State Auditor and Inspector