

Office of Inspector General

**U.S. Department of Labor
Office of Audit**

**Audit of the
Nevada Department of Employment,
Training and Rehabilitation's
Year 2000 Grant Expenditures**

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ACRONYMS

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|--------|---|---|
| DOL | - | U.S. Department of Labor |
| ES | - | Employment Service |
| ETA | - | Employment and Training Administration |
| FY | - | Fiscal Year |
| IV & V | - | Independent Verification and Validation |
| DETR | - | Department of Employment, Training and Rehabilitation |
| FIFO | - | first-in, first-out |
| MSA | - | Master Service Agreement |
| OIG | - | Office of Inspector General |
| SBR | - | Supplemental Budget Request |
| SESA | - | State Employment Security Agency |
| UI | - | Unemployment Insurance |
| Y2K | - | Year 2000 |

EXECUTIVE SUMMARY

During Fiscal Years (FYs) 1998 and 1999, Congress appropriated funds to help State Employment Security Agencies (SESAs) make their automated Unemployment Insurance (UI) and Employment Service (ES) systems Year 2000 (Y2K) compliant. The U.S. Department of Labor (DOL), Employment and Training Administration (ETA) awarded the Nevada Department of Employment, Training and Rehabilitation (DETR) grants totaling \$8,117,147 from funds appropriated for Y2K readiness.

The Office of Inspector General (OIG) examined Y2K expenditures of \$7,407,547 made by DETR, from the grants' inception through September 30, 2000. Our audit objective was to determine whether Y2K funds were spent for intended purposes, in conformity with the grant agreements and applicable Federal requirements.

DETR did not always adhere to ETA's requirements governing the use of Y2K funds. We identified grant expenditures, totaling \$758,427 that were not in accordance with Federal requirements. Y2K grant costs we have questioned include:

- \$568,298 of charges incurred before the grant period; and
- \$190,129 in charges related to contracts that involved multiple tasks, some of which did not involve Y2K readiness.

DETR did not separately account for charges to the Y2K grants. Better accounting practices would have allowed DETR to identify charges related to each project and to have avoided problems concerning applicability of the costs to the Y2K grants, in contracts that involved several tasks.

We recommend that the Assistant Secretary for Employment and Training recover \$758,427 in expenditures we questioned. We also recommend, in the future, that ETA ensure DETR's accounting procedures adequately identify allowable and allocable grant charges.

In its response to our draft report, DETR provided clarification and additional documentation concerning charges against the Y2K grants for projects not approved by ETA. After our review and consultation with ETA on these issues, charges of \$436,945 in questioned costs have been removed from the report. Consequently questioned costs have been reduced to \$758,427.

INTRODUCTION AND PRINCIPAL CRITERIA

ORIGIN AND PURPOSE OF Y2K FUNDS

In FY 1998, concerns with the approach of Y2K and the potential for problems with automated systems prompted Congress to provide the states with grants that totaled \$205 million. The funds were to help ensure SESAs' automated UI and ES systems were Y2K compliant.

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 business continuity or contingency plans, in the event of Y2K-related shutdowns of critical UI and ES systems, or for independent verification and validation (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 Supplemental Budget Requests (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 the funds were awarded based upon what the panel judged were "reasonable and allowable" costs.

In Fiscal Year 1999, ETA reprogrammed an additional \$50 million of UI contingency funds to address the SESAs' Y2K needs. The funds were awarded to the SESAs through SBRs. ETA required the SESAs to demonstrate a "compelling need," in order for the funds to be considered for the FY 1999 awards.

Y2K FUNDS PROVIDED NEVADA

Overall, DOL provided the State of Nevada \$8,117,147 for Y2K readiness. During FY 1998, DETR received \$6,290,767 in Y2K grants. The total included \$1 million of base funding, \$180,000 for independent IV & V activities, and \$5,110,767 Nevada received through SBRs.

During FY 1999, DETR requested and received \$1,826,380 in additional funds through two SBRs. The first SBR was for \$1,437,400, and the second request was for \$388,980. In August 2000, DETR requested and was granted authority to redirect \$158,443 of the \$1,437,400 to purchase computer hardware supporting Nevada's development of a Y2K compliant UI Appeals system. DETR also requested and received permission to redirect \$194,375 of the \$388,980 award, to purchase computer hardware for improvements to Nevada's information technology infrastructure. As of September 30,

2000, DETR reported it had spent the entire \$6,290,767 of FY 1998 Y2K grant funds and \$1,116,780 of its FY 1999 Y2K funds.

PRINCIPAL CRITERIA

ETA Field Memorandum 50-97, dated August 4, 1997, provided the following guidance for the use of FY 1998 Y2K funds:

The Y2K Compliance projects for which funds are received must focus on activities relating to Year 2000 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.

Guidance on the use of FY 1999 Y2K supplemental funding was included in ETA Field Memorandum 3-99, dated October 13, 1998:

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 Y2K 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. Additionally, the SESA must demonstrate that the funds will materially assist the SESA in achieving its Y2K compliance goals.

The "Executive Summary" of ETA's "Year 2000 SBR Review Panel's Briefing Package" 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 objective of this audit 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 examined Y2K grant funds received by DETR during the period 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.

DETR received a total of \$8,117,147 from ETA for Y2K compliance activities. As of September 30, 2000, DETR reported it had spent \$7,407,547 of the funds it was awarded. Subsequent to completing our field work, ETA allowed DETR to redirect \$352,818 in remaining Y2K funds to data processing infrastructure needs.

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States and included such tests as we considered necessary to satisfy the objective of our audit. Our review of internal controls was limited to those related to the FY 1998 and FY 1999 Y2K grants. Our audit was made for the purpose of determining if requirements for the use of Y2K grant funds had been followed. We do not express an opinion on whether grant costs have been reported to ETA, at September 30, 2000, in accordance with reporting instructions. Our fieldwork began September 2000 and continued into February 2001.

As further discussed in this report, we have questioned \$758,427 of grant funds we do not believe were spent in compliance with Y2K grant agreements or other applicable Federal criteria.

RESULTS OF AUDIT

Although DETR avoided interruption of ES and UI services, it did not always comply with ETA's requirements governing the use of Y2K grant funds. We identified grant expenditures of \$758,427¹ that were not spent in accordance with requirements. For purposes of discussion, we have classified questionable Y2K grant charges into the following categories:

- \$568,298 of costs that were incurred before the grant's start date; and
- \$190,129 in charges related to multiple-task contracts, in which some of the tasks were unrelated to Y2K purposes.

Y2K GRANTS WERE CHARGED \$568,298 FOR WORK PERFORMED BEFORE THE GRANTS WERE EFFECTIVE

DETR charged \$568,298 to a Y2K grant for contract work performed prior to the grant's start date of October 1, 1997.

ETA Field Memorandum 50-97 provides:

*The Y2K Compliance projects for which funds are received must focus on activities relating to Year 2000 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. **The funds cannot be applied retroactively to work performed or to products already purchased prior to October 1, 1997, but maybe applied anytime after October 1, 1997, regardless of when the appropriation is passed.** [Emphasis added.]*

In March 1997, DETR entered into a \$4.3 million contract with an information technology firm. We reviewed 15 invoices dated prior to October 1, 1997, that totaled \$1,050,799.64. We determined

¹ We questioned costs of \$1,195,372 in our draft audit report. After analysis of documentation provided in DETR's response and discussions with ETA, we have removed \$436,945 in questioned costs.

that seven of the invoices totaling \$568,298 were charged to the FY 1998 Y2K grants, even though the work was performed prior to the Y2K grant's October 1, 1997 effective date.

DETR officials agreed that three of the vendor's invoices totaling \$262,510 should not have been charged to the Y2K grant, because the delivery and acceptance dates were prior to October 1, 1997. However, DETR argued that the remaining four invoices contained allowable charges, because the contracts required the deliverables be "accepted for review" and that DETR did not accept the deliverables until after October 1, 1997.

DETR indicated its position is consistent with Federal Accounting Standards, the Governmental Accounting Standards Board and Nevada Revised Statute 353.3241(2) which states that "Expenditures must be recognized in the accounting period in which the liability of the fund is incurred. . ."

We disagree. The issue is not when expenditures should be recognized, from an accounting perspective, but the period in which the work was performed. The language in Field Memorandum No. 50-97 clearly prohibits using grant funds for work performed prior to October 1, 1997. The charges we have questioned, on all seven invoices involve work that was performed prior to October 1, 1997, even though four invoices may have contained deliverables that were not "accepted" until some time after October 1, 1997.

**GRANTS WERE CHARGED FOR SOME
TASKS THAT WERE NOT Y2K-RELATED**

DETR charged Y2K grants for work performed on activities that were not Y2K-related. The Master Service Agreements (MSAs) that we do not believe was entirely Y2K related, involved development of Nevada's One-

Stop operating and UI appeals systems.

In addition to receiving Y2K funds for its ES and UI systems, DETR also received DOL monies to implement a One-Stop web site. One-Stop is an integrated service delivery system required by the Workforce Investment Act that allows persons to apply for a variety of social services at one location.

DETR contractors worked on both One-Stop and ES/UI Y2K concerns. However, their costs for selected periods of time were charged exclusively to Y2K grants. Charges of \$190,129 were made to Y2K under the following work orders:

- Work Order Number 098 involved development of DETR's Internet applications and the One-Stop system. The Y2K grant was charged for the entire \$115,629 spent in FY 1999.
- Work Order Number 256 was for computer work related to both the UI appeal's system and the One-Stop operating system. The total cost of \$74,500 was charged to the FY 1999 Y2K grants.

DETR officials told us they believed the \$115,629 spent on Work Order Number 098 was properly charged to the FY 1999 Y2K Grant. The Agency explained the task involved only one contract employee who was assigned as project implementor of the new UI appeals system, as of April 15, 1999. According DETR officials, the contractor's time was charged to the Y2K grant from May 1, 1999, until the appeals system was implemented in October 1999.

The MSA associated with the work order indicates the contractor's tasks related to the One-Stop system. We noted that the work order had been amended seven times since January 6, 1997. However, the amendments did not alter the description of the contractor's tasks. They continued to be described as involving One-Stop applications. DETR officials maintain that the contractor worked exclusively on Y2K issues, although the contract was not modified to reflect changes in the scope of the tasks. DETR did provide us documentation that indicates the contractor did some work on Y2K projects. However, the documentation is not sufficient to determine the portion of the contractor's time spent working on either Y2K or One-Stop systems.

The other MSA in question (Work Order Number 256) involves a contractor who was hired to develop DETR's data processing operating environment. This environment is used by both the One-Stop and appeals systems. DETR agreed that some of the costs did not relate to Y2K projects and proposed that 50 percent of the contract costs should have been charged to the Y2K grants. However, DETR did not provide us any documentation of how they arrived at the proportion of costs the Y2K grants should bear.

We agree that the costs of both contracts should have been allocated between the Y2K and One-Stop grants. However, charges should be supported by empirical evidence of the work performed on the various projects. As discussed in the following section of this report, better accounting of the Y2K funds could have reduced uncertainties concerning the allowability of charges.

**BETTER ACCOUNTING PROCEDURES COULD
HAVE PREVENTED SOME AUDIT EXCEPTIONS**

DETR did not separately account for funds awarded under the various Y2K grants. Instead, DETR aggregated the various grants by fiscal year and reported them on a “first-in, first-out” (FIFO) basis.

Rather than separately account for each award, DETR combined the amounts by the year in which they were received. For example, the FY 1998 Y2K grant awards were reported as one line-item revenue amount of \$6,290,767, although FY 1998 Y2K awards consisted of a \$1 million base grant, \$180,000 for IV & V testing and \$5,110,767 for specific tasks identified in an SBR.

Also, DETR accounted for grant expenditures on an FIFO basis. That is, expenditures were charged to the oldest Y2K grant, until the total amount of funds awarded under that grant were exhausted, then the next oldest grant was charged, and so on. DETR reported both FY 1998 and FY 1999 Y2K expenditures as one amount, on its “Status of Obligation Authority” report. Consequently, FY 1998 and FY 1999 Y2K grant expenditures were reported as FY 1998 grant costs, to the extent FY 1998 grant funds were available.

DETR explained they had complied with DOL’s reporting requirements. DETR indicated ETA did not require costs to be reported separately for each grant on the required financial reports (Standard Form SF 269). We agree that requirements set forth by DOL did not require separate reporting of Y2K grants. However, separate tracking of costs would have allowed DETR to identify charges related to each Y2K grant and should have eliminated some of the issues raised in this report concerning applicability of the costs. It could also have allowed DETR to more effectively manage its Y2K projects.

CONCLUSION

ETA provided significant funds to help DETR meet its Y2K requirements. With the funding came specific requirements governing the use of these funds. Funds that were not spent in accordance with the requirements should be recovered.

RECOMMENDATIONS

We recommend the Assistant Secretary for Employment and Training recover a total of \$758,427 in improperly charged or unsupported Y2K costs. The charges include:

- \$568,298 of charges incurred before the grant period; and
- \$190,129 in contractors' costs that we could not identify as having been spent on Y2K readiness.

We further recommend the Assistant Secretary make certain, in the future, that DETR's procedures are adequate to account for special awards and ensure the funds are spent in accordance with grant requirements.

NEVADA'S COMMENTS ON THE DRAFT AUDIT REPORT

DETR disagreed with our finding that Y2K Grants were charged \$568,298 for work that was performed before the grants were effective. DETR argued that \$305,789 of the \$568,298 involved four individual purchases that occurred after October 1, 1997, and were therefore, allowable charges.

DETR contends:

The 4.3 million dollar contract that DETR entered into was a conditional and separable contract, not an absolute agreement to purchase based on time and materials. That is, the products or deliverables were considered as many distinct contracts or contracts to purchase, which were entered into at one time and each product or deliverable was dependent on the condition of completion and acceptance being met. . . .

In summary, DETR maintains that due to the conditions of the contract and consistent with ETA Field Memorandum 50-97, the relevant factor for determining the timing of appropriate charges to the grant would be the date the purchase occurred rather than when the work was performed.

DETR also disagreed with a finding in our draft report that Y2K grants were charged \$463,945 for activities ETA did not approve. DETR's response indicates the \$436,945 was a proper charge to the

FY 1998 SBR. After the 1998 Research and Analysis funding request was denied, DETR contends it had to create interface programs that would convert GUIDE UI DATA into a format that emulated the Legacy system files and databases so that DETR could continue to report UI activity after the GUIDE UI system went live.²

DETR expressed partial agreement with finding that Y2K grants were charged \$190,129 for some tasks that were not Y2K-related, involving Work Orders 098 and 256.

DETR commented that \$115,629 applied to Work Order number 098 was properly charged to the 1999 Y2K grant. In support of its position, DETR attached the contractor's affidavit that provided:

. . . effective May 1, 1999 I was assigned exclusively to the Nevada UI Appeals Y2K replacement project. During the months of May, June and July 1999 I was spending less than 5% of my time on residual assignments. By August of 1999, I was spending 100% of my time on UI Y2K applications.

In addition a copy of an E-mail was provided indicating the contractor “. . . began working pretty much full time on the appeals project effective 4/26/99. . . .”

Concerning Work Order number 256, DETR maintained its position that the total of \$74,500 charged to Y2K grant should be equally split between Y2K and One-stop related activities. DETR's indicates the basis for a 50-50 allocation of the contractor's time is found in Section F. of OMB Circular A-87 Attachment A, “General Principles for Determining Allowable Costs,” which defines indirect costs as those that benefit more than one cost objective and are not readily assignable to a particular cost objective.

DETR agreed with our finding that the management of grant expenditures could have been improved through the use of better accounting procedures.

ANALYSIS OF NEVADA'S COMMENTS

Y2K grants were charged \$568,298 for work performed before the grants were effective. We disagree with DETR's response that the date the “purchases occurred” should be used to determine the

²As discussed under “Analysis of Nevada's Comments,” information provided in DETR's response to our draft report was sufficient to remove this amount from questioned costs.

timing of appropriate charges. As previously discussed, ETA Field Memorandum 50-97 clearly specifies, "The funds cannot be applied retroactively to work performed or to products already purchased prior to October 1, 1997."

The scheduled delivery date of each invoice we questioned was on or before October 1, 1997. Although the work may not have been accepted until shortly after October 1, 1997, it was contracted for and substantially complete prior to October 1, 1997. Consequently, we continue to question the entire \$568,298.

In our draft report, we also questioned \$463,945 associated with conversion of data related to Research and Analysis system, because ETA had previously refused funding for these activities. DETR's FY 1998 requests for \$621,040 to modify and convert the Research and Analysis system was denied by ETA. Subsequently, DETR spent \$463,945 of FY1998 funds to convert its new Guide system data to the old Legacy format.

The response indicates that since DETR were denied funds to convert the Research and Analysis programs as proposed in the FY 1998 SBR, they "patched" the system by creating interface programs that would convert GUIDE UI data into a format that emulated the Legacy UI System files and databases. Subsequently, they were awarded \$220,000 in FY 1999 SBR funds to patch the critical programs of the old Research and Analysis system.

DETR should have sought ETA approval prior to spend funds associated with modifying or converting data related to the Research and Analysis programs. However, based on additional information provided in the response and after consultation with ETA officials, we believe the funds were spent on allowable Y2K activities. Consequently, we have removed \$463,945 associated with this finding from our questioned costs.

We reported that costs relating to Work Orders (098 and 256) were charged entirely to the Y2K project, even though there were indications that work which was performed benefitted more than one project.

DETR's response included a contractor affidavit and copies of electronic-mail messages that indicates the contractor was "working pretty much full time on the Appeals system." However, the charges are not supported by the statement of work in the contract which continued to describe the work as involving one-stop applications.

DETR suggested that 50 percent of work order number 256 should have been charged to the Y2K grants. DETR proposed that because the contractor worked on two projects, costs should have been equally split between the two. DETR indicates that the contractor was hired to

prepare an operating environment which was to provide the platform for both appeals and the One-Stop system. However, no documentation was offered that supports an equitable charge to the Y2K grant. Consequently, we continue to question \$190,129 in contractors' costs associated with these work orders.

ATTACHMENT

**THE COMPLETE TEXT OF NEVADA'S
RESPONSE TO THE DRAFT AUDIT REPORT**

(Follows This Title Page)