Agreed-Upon Procedures Report
on the Commonwealth of Pennsylvania
Department of Labor
And Industry's (PA DOL&I)
Year 2000 Grant Expenditures

FINAL REPORT

This agreed upon procedures were performed 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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Report Number: 04 01 005 03 315
Date Issued: August 22, 2001

KPMG
Information Risk Management
Washington, DC

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ACRONYMS

BMIS	Bureau of Management Information Systems
DOL	United States Department of Labor
DOL&I	Department of Labor & Industry
ES	Employment Security
ETA	Employment and Training Administration
FL	Field Purchase Order
FY	Fiscal Year
FPY	Fiscal Program Year
IV&V	Independent Verification and Validation
OIG	Office of Inspector General
LAN	Local Area Network
PC	Personal Computer
SBR	Supplemental Budget Request
SESA	Statement Employment Security Agency
UI	Unemployment Insurance
Y2K	Year 2000

EXECUTIVE SUMMARY

During Fiscal Years (FYs) 1998 and 1999, Congress appropriated funds to assist State Employment Security Agencies (SESAs) with 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 Pennsylvania Department of Labor and Industry (hereafter referred to as *"the State"*, "*PA*" or *"the Agency*") $11,786,862 in supplemental Federal funding for Y2K compliance activities.

A total of $10,786,862 was received through Supplemental Budget Requests (SBRs) and $1 million dollars was provided in FY 1998 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. FY 1998 SBR funding amounted to $9,786.862. In FY 1999, the Agency received additional SBR funding of $1 million. The table below summarizes the Y2K supplemental Federal funding awards received by PA:

Fiscal Year	Base Grant Awards	SBR Awards	Total
1998	$1,000,000	$ 9,786,862	$10,786,862
1999	-----	$ 1,000,000	$ 1,000,000
Total	$1,000,000	$10,786,862	**$11,786,862**

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 Harrisburg, PA, during the period of February 26, 2001 through April 6, 2001. The cooperation received from Agency staff greatly facilitated the engagement

Of the $11,786,862 in Y2K awards, PA spent $11,241,650.99 as of February 28, 2001. KPMG received and examined supporting documentation for $11,179,282.13, or 99 percent of the total expenditures.

Overall, KPMG believes that the State made conscientious efforts to expend Y2K funds in accordance with guidelines. However, there were instances where the Agency did not adhere to ETA's requirements governing the use of Y2K funds. We identified grant expenditures totaling $246,261.50, that were not spent in accordance with Federal requirements.

Costs we have questioned are broken down into the following categories:

- $115,047.78 expended on purchases that were not necessary to ensure Y2K readiness;
- $60,370.22 in salary and fringe benefit costs that either did not meet spending requirements or which were improperly calculated; and
- $70,843.50 of costs posted to the FY 1999 fund ledger for *"Resources on Order"* which were not supported as Y2K-related.

We recommend that the Assistant Secretary for Employment and Training recover $246,261.50 in expenditures, net of any adjustments, and *"Resources on Order"* related to purchases that we questioned.

We also identified $459,198.45 of unexpended and unobligated FY 1999 Y2K funds as of February 28, 2001. We recommend the Assistant Secretary deobligate these funds if PA's proposed use of the remaining amount is determined to be an inappropriate use of the Y2K grant. The $459,l98.45 of remaining unobligated funds reported, as of February 28, 2001, will change as a result of any disallowed costs or any accounting adjustments made by PA.

PA provided written comments to KPMG's Draft Report, issued on June 1, 2001. We have included each of their comments, verbatim, after each finding in the report. In addition, the Final Agreed-Upon Procedures Report includes a conclusion reached by KPMG regarding PA comments as it relates to each specific finding identified during the review. We have included the entire text of the Commonwealth's comments as Attachment A of this report.

INTRODUCTION AND PRINCIPAL CRITERIA

Origin and Purpose of Year 2000 Funds

In FY 1998, 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.

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 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 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 FY 1999 awards.

Y2K Funds Provided to the Commonwealth of Pennsylvania

The Commonwealth of PA received $11,786,862, in supplemental Federal funding, for Y2K compliance activities. A total of $10,786,862 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 automated systems and $180,000 for IV & V. FY 1998 SBR funding amounted to $9,786.862. In FY 1999, the Agency received additional SBR funding of $1 million.

SBR funds awarded in FY 1998 expired on December 31, 2000, and FY 1999 funds will expire on December 31, 2001. Based upon PA's financial records, as of February 28, 2001, $545,211.99 of the FY 1999 funds had not been spent. *"Resources on Order"* amounted to $86,013.54 and remaining unobligated funds available were $459,198.45.

Principal Criteria

Guidelines for spending Y2K supplemental funds were contained in ETA Field Memoranda, the ET 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 FY1998 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 aversely 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 examined 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 U.S. Department of Labor, Office of Inspector General and found in the *DOL-OIG Engagement Guide-Y2K SESA Spending* and included such tests as we considered necessary to satisfy the objectives of the engagement. The agreed-upon procedures engagement (AUP) 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 FY1998 and FY1999 Y2K funds. Fieldwork began February 2001 and continued into April 2001.

INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

Mr. John J. Getek
Assistant Inspector General for Audit
United States Department of Labor
Office of Inspector General
200 Constitution Ave., NW – Room S5022
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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 of Pennsylvania's Department of Labor and Industry's (PA DOL & I) compliance with the 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 ODJFS's compliance assertion on its utilization of the funds granted by 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.

By ________/s/_________________________ Date ____8/21/01__________
Partner, KPMG,LLP

RESULTS OF AGREED-UPON PROCEDURES

Through its remediation efforts, the State avoided interruption of UI and ES services at January 1, 2000. However, they did not always adhere to ETA's requirements governing the use of Y2K funds. We identified grant expenditures totaling $246,261.50, 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:

- $115,047.78 expended on purchases of equipment, warranties, and related peripherals that were not necessary to ensure Y2K readiness;

- $60,370.22 in salary and benefit costs that either did not meet ETA's Y2K spending requirements or which were improperly calculated; and

- $70,843.50 of costs posted to the FY 1999 fund ledger for *"Resources on Order"* which are not supported as Y2K-related.

Additionally, we believe uses proposed for the remaining unobligated FY 1999 Y2K funds totaling $459,198.45 are not in conformity with ETA's guidance.

$115,047.78 WAS EXPENDED ON EXTENDED WARRANTIES, PRINTERS AND RELATED PERIPHERALS THAT WERE NOT NECESSARY TO ENSURE Y2K READINESS

KPMG reviewed each of the purchasing source documents provided by PA and identified a total of $115,047.78 spent on extended warranties, laser printers and related peripherals. The amount consists of the following items:

- $86,971 of Federal Y2K funds used to purchase extended warranties for 421 personal computers, 421 monitors and local area network (LAN) hardware.

- $28,076.78 used to purchase 15 laser printers and related peripherals.

Purchases of Extended Warranties on Equipment Were Not Y2K-Related Necessities. KPMG analyzed source purchasing documents to assess the expenditure of Federal Y2K funds. During the analysis, we identified a total of $86,971 in Y2K Federal funds that were spent on extended warranties for hardware and software purchased for Y2K purposes.

The Agency noted the following as consideration for the expenditure of funds for the purchase of extended warranties as an allowable cost:

> *The Department purchased the extended warranties with the equipment in order to ensure a cost savings under the Federal grant. The equipment came with a 3 year warranty with the first year on-site and the second and third year parts only. It was less expensive to purchase the warranty upgrade than ensure qualified staff for diagnostics/parts replacement or pay maintenance contract charges during the 2nd and 3rd years.*

KPMG recognizes that the purchase of upgraded warranties may be less expensive than hiring additional staff. However, we question whether the warranty upgrades were necessary for Y2K-compliance. In its comments, the Agency indicated the expenditures were for equipment maintenance-related purposes; however, the comments did not identify the expenditures as Y2K necessities.

KPMG believes the warranties did not satisfy guidance provided by ETA for use of Y2K funds provided through SBRs. ETA's ET Handbook No. 336, 16th 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's does not consider the purchase of warranties 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.

Y2K Funds Were Used to Purchase Printers and Related Peripherals That Were Not a Y2K Necessity. During our review of source purchasing documents, KPMG found Y2K funds had been used to purchase printers and related peripherals, in November 1998. Interviews with PA staff and our examination of supporting documentation made it evident the Agency was aware the printers were not allowable Y2K-related items. However, under field purchase order (FL) 1217908, dated November 5, 1998, the Agency purchased fifteen printers and related peripherals, in the amount of $28,076.78, with FY 1999 Federal funds.

ETA Field Memorandum 47-99, dated July 14, 1999, communicated the following guidelines regarding the use of FY 1999 SBR funds:

> *These funds cannot be applied to purchases of personal computers (PCs), peripheral devices (printers, modems, monitors, etc.) or PC-based office support applications such as electronic mail, spreadsheets, or word processors.*

Additionally, 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 State did not substantiate the purchase of the printers and related peripherals as Y2K-related. Rather they indicated the following:

> *If the costs associated with the purchase of the printers and related peripherals are determined to be unallowable, the Department will move the associated costs to the appropriate grants.*

KPMG has determined that PA did not comply with ETA's requirements. The purchase of printers and related peripherals do not meet the criteria established for use of FY 1999 Y2K funds. Additionally, there was no compelling need identified for purchases made by the Agency that demonstrated that the printers and peripherals materially assisted the SESA in achieving its Y2K compliance goals.

PA's Comments Regarding Extended Warranties, Printers and Related Peripherals

PA commented, in its response to KPMG's Draft Report dated June 1, 2001 that:

> *The Department has nothing further to add at this time.*

KPMG's Analysis of PA's Comments Regarding Extended Warranties, Printers and Related Peripherals and Recommendation

The State offered no further comment regarding the questioned expenditures of $115,047.78 on extended warranties, printers and related peripheral purchases. PA previously stated that purchases of the extended warranties was a cost savings over hiring additional personnel to perform diagnostic and maintenance duties. It is apparent that the warranties benefited PA by providing on-going and routine maintenance for hardware, but were not required for Y2K compliance.

With regard to the printers and related peripherals, PA has indicated that if the costs are disallowed, they will be moved out of the Y2K grant fund to the appropriate ledger. Our position remains that these purchases did not comply with ETA's spending criteria nor were a compelling need for their purchase identified.

We recommend that the Assistant Secretary for Employment and Training disallow costs related to extended warranty, printers and related peripheral purchases and recover the full amount of $115,047.78.

$60,370.22 WERE IMPROPERLY CHARGED AS SALARY AND BENEFITS COSTS

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 of additional staff hired to work on critical Y2K-related projects incurred after October 1, 1997. In Field Memorandum 50-97, dated August 4, 1997, ETA established that for FY 1998 Y2K 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.*

PA spent $361,978.45 of Y2K Federal funds on personal services and personnel benefits. Salary expenditures were authorized for only two annuitants hired to perform Y2K services. Overtime costs were authorized for personnel in the Bureau of Management Information Systems (BMIS) over the duration of Y2K remediation efforts. During the month of January 2000 only, approval was given to personnel from other bureaus to charge overtime hours to verify computer systems after the millennium date rollover.

KPMG identified a total of $60,370.22 in salary and benefits costs which were not Y2K related or were improperly calculated. The amount consists of the following items:

- $37,911.49 of overcharges resulting from a miscalculation of a March 1998 transfer of overtime charges.
- $5,932.84 of overcharges resulting from a miscalculation of benefits associated with the March 1998 transfer.
- $15,511.97 of salary charges that were not Y2K-related.
- $1,013.92 of overtime charges that were not Y2K-related.

Transferable Overtime Charges Were Miscalculated as Allowable Y2K Costs. Salary charges incurred after October 1, 1997 were allowable FY 1998 SBR costs. In March 1998, PA transferred overtime costs incurred between October 1997 and January 1998 to the FY1998 Y2K funds ledger. In total, $63,673.39 was transferred. However, KPMG reviewed the supporting documentation provided by the Agency and found the amount had been incorrectly calculated. Because of an administrative error, PA summed the cumulative amounts reported at the end of each month rather than the monthly amounts. The correct amount of the transfer should have been $25,761.90 resulting in the $37,911.49 overcharge.

The Agency concurred with this finding and advised that $37,911.49 would be removed from Y2K costs.

Benefits Were Miscalculated as a Result of Incorrect Overtime Charges. In addition to the transfer of overtime charges, associated Social Security retirement and Workers' Compensation benefits in the amount of $9,964.37 were computed and charged as Y2K costs. However, the amount of benefits associated with the March 1998 transfer was based on the incorrect overtime calculation and consequently an overcharge for benefits occurred.

PA concurred with our finding and recalculated the associated benefits transfer amount noting the following:

> *The transfer error also had a component for benefit costs. Although the benefit transfer totaled $9,964.37, the amount of the actual overcharge was $5,932.84. The amount of $5,932.84 will be removed from the Y2K costs.*

Agency Base-Funded Staffing Costs Were Charged as Y2K Regular Salary Costs. DoI provides each State SESA with annual appropriations which include monies for "base-funded" personal services and benefits costs. During a review of salary costs, we determined that regular base-funded staff had charged $15,511.97 to the Y2K Federal funds.

With regard to the use of Y2K funds, guidelines were established for use of funds for salary costs incurred by SESAs, as a result of Y2K remediation efforts. The use of funds to pay for base-funded staffing costs was specifically disallowed. In Field Memorandum 50-97 dated August 4, 1997, ETA established that for FY 1998 Y2K 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.*

A similar guideline is provided in ETA Field Memorandum 47-99, dated July 14, 1999, regarding FY1999 SBR funds:

> *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.*

The State agreed that the charges were not Y2K-related and responded that the $15,511.97 would be removed as Y2K costs.

Non Y2K-Related Costs Were Charged as Y2K Overtime Costs. Our review of FY 1999 Y2K overtime charges incurred after January 1, 2000 identified $1,013.92 of overtime costs that were improperly charged as Y2K costs. Agency management confirmed that the employee whose charges were in question had not performed Y2K-related work.

PA concurred with our finding and agreed to move the costs to the appropriate fund ledger.

PA's Comments Regarding Salary And Benefits Costs

PA's comments to KPMG's Draft Report dated June 1, 2001, relative to these questioned costs were:

> *On May 22, 2001 a memo outlining the specific transfers to be made was prepared by the Y2K Coordinator of the Office of Information Technology and forwarded through the Bureau of Financial Management to the Comptroller's Office for appropriate action. Requested transfers out of the Y2K grants totaled $60,370.22 and were accomplished in May 2001.*
>
> *During the review it was also determined that two annuitants had charged time to grants other than Y2K which should have gone against the Y2K grant. Those charges amounted to $6,801.74. It was requested, in the May 22 memo, that they be transferred to the Y2K grant. This was also accomplished in May 2001.*

KPMG's Analysis of PA's Comments Regarding Salary and Benefits Costs and Recommendation

The remaining Y2K fund balance will be adjusted for the $6,801.74 associated with work performed by the two annuitants that has been transferred into the grant.

PA has concurred with our finding that the questioned salary and benefit expenditures were either not allowable Y2K-related costs or the result of miscalculations. We recommend that the Assistant Secretary for Employment and Training recover the full amount of $60,372.22 that has been transferred out of the Y2K grants.

$70,843.50 OF RESOURCES ON ORDER AGAINST THE FY1999 FUNDS COULD NOT BE SUPPORTED AS Y2K-RELATED COSTS

As of February 28, 2001, unexpended FY 1999 funds totaled $545,211.99. Of this amount, $86,013.54 had been obligated and $459,198.45 was unobligated. KPMG requested supporting documentation identifying the intended use of the $86.013.54 in ledger line items for capital purchases and services indicated as *"Resources on Order"* to determine if the purchases were allowable under ETA's Y2K spending guidelines.

We determined $51,154.00 of *"Resources on Order"* was erroneously charged to the FY 1999 Y2K Federal fund ledger. In response, the Agency issued an Advice of Change memorandum dated March 23, 2001 and a memorandum dated March 26, 2001 instructing that these costs be reversed from the Y2K ledger. The State responded that action to resolve this issue was taken during fieldwork.

PA also confirmed that an additional obligation of $19,689.50 of FY1999 funds for *"Resources on Order"* was not Y2K-related and has requested that the amount be removed from Y2K costs. In total, the Agency was unable to substantiate $70,843.50 of FY1999 funds obligated as *"Resources on Order"* as Y2K related.

PA's Comments Regarding Resources On Order Against FY1999 Funds

In comments to KPMG's Draft Report dated June 1, 2001, the Agency stated:

> *The $70,843.50 in "Resources On Order" has been moved out of the Y2K Grant.*

KPMG's Analysis of PA's Comments Regarding Resources On Order Against FY1999 Funds and Recommendation

PA has concurred with our finding that the *"Resources On Order"* against FY 1999 Y2K funds were for non-related Y2K purchases. PA also stated that the obligations, in the amount of $70,843.50 against FY 1999 available funds, have been removed.

AS OF FEBRUARY 28, 2001, REMAINING UNOBLIGATED FY1999 FUNDS AMOUNTED TO $459,198.45

FY 1999 Y2K funds are to be obligated by September 30, 2001 and expended by December 31, 2001. As of February 28, 2001, State financial records indicated $459,198.45 of FY 1999 funding had not been obligated and remained unspent. It is noted that as adjustments are made to the ledger account as a result of the agreed-upon procedures engagement, the amount of remaining funds will change accordingly.

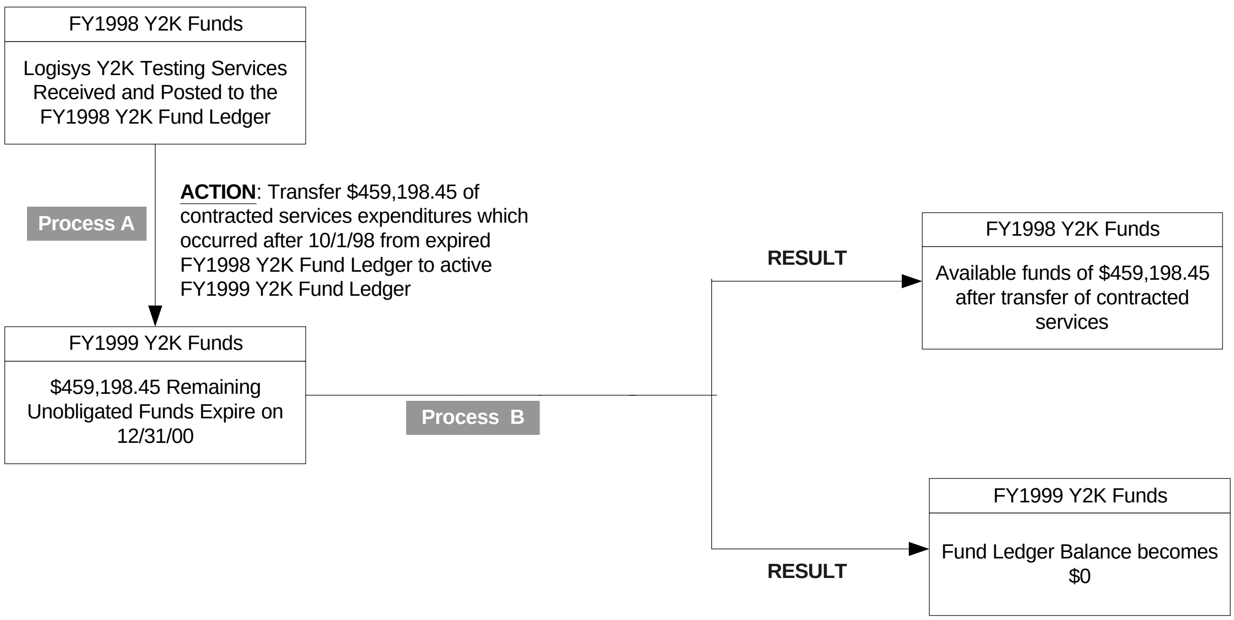
By the conclusion of fieldwork, the State had provided KPMG with its plans to spend the unobligated funds. The State intends to transfer expenses already incurred and posted to other ledger accounts to the Y2K grants. The transfers are summarized as follows:

- $459,198.45 in contracted Y2K testing services received from Logisys, Inc. from the FY 1998 Y2K fund ledger to the FY 1999 Y2K fund ledger.
- $459,198.45 of personal computer (PC) costs from the ES FPY 1998 fund ledger to the FY 1998 Y2K fund ledger.

At the conclusion of fieldwork, the Agency noted its intention to release a letter to the DOL ETA for approval of the proposed transfers.

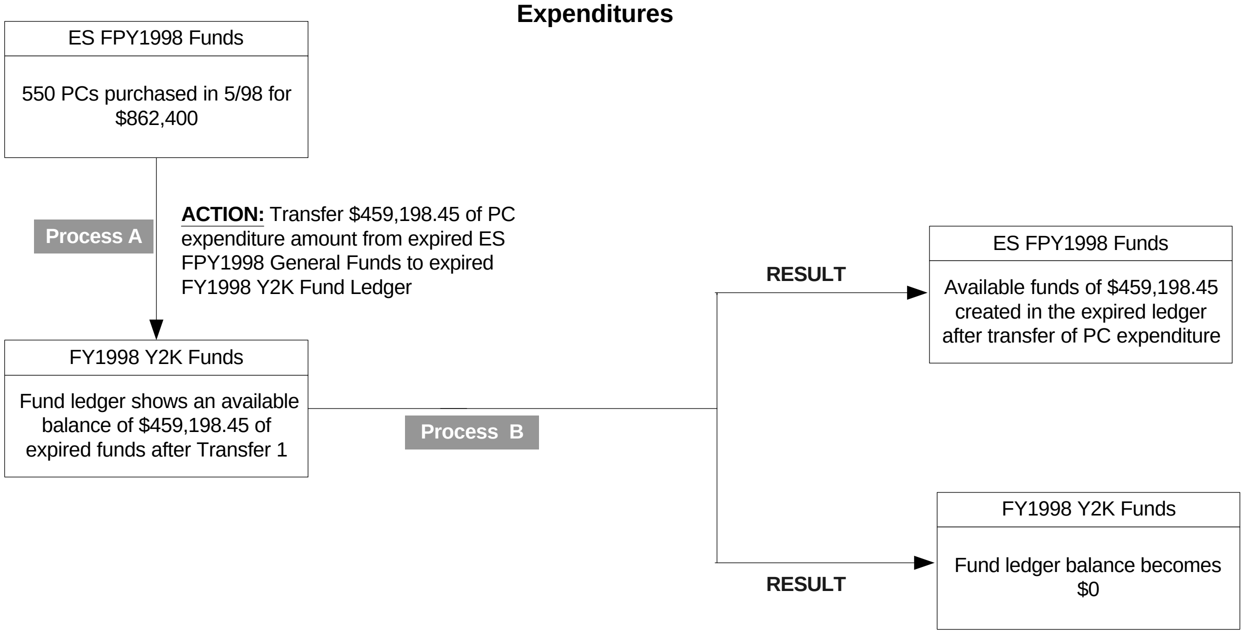
Figures 1 and 2, which follow on the next page, illustrate the proposed transfers and their affects on financial ledgers:

Figure 1
Transfer of Contracted Services Expenditures



NOTES
1. Y2K contracted testing services allowable under FY1999 Y2K SBR funds.
2. Allowable FY1999 Y2K expenditures must be incurred on or after 10/1/98.

Figure 2
Transfer of PC Expenditures



NOTES
1. The date of the PC expenditure makes the purchase an allowable cost with FY1998 Y2K funds, but not with FY1999 Y2K funds.
2. ES FPY98 and FY1998 Y2K funds are expired.
3. PA has not indicated how available funds created in the ES FPY1998 ledger will be addressed.

The proposed transfers and PA's intention to expend the remaining FY 1999 Y2K funds raise a number of concerns, which KPMG feels should be adequately considered during DOL ETA's review of the Agency's request for approval. Concerns related to the proposed use of remaining FY 1999 Y2K funds are outlined as follows:

- The proposed transfers originate from expenses already incurred and posted against funds that have expired. If the transfers are approved, a remaining available funds balance in the ES FPY 1998 funds will be created. The resulting remaining balance would consist of expired funds and does not appear to be available to satisfy for current expenses incurred. The State has not addressed the affect of the resulting available balance of these funds.

- KPMG questions whether the purchase of the PC's proposed for transfer are allowable as a Y2K-necessitated expense. The original justification for the purchase of the PCs described in the Agency's Request to Acquire dated April 30, 1998 is noted below:

> *The requested resources will be utilized by the PA Job Centers to access the Career Development Marketplace Internet/Intranet System being implemented later this year. . . .*
> *Devices which are not "internet capable" must be replaced.*

KPMG reviewed the SBR submitted by the State and did not find that Y2K funds were requested from ETA for this particular purchase. On June 8, 1999, a memorandum was submitted to the Agency's Y2K Coordinator which stated that the purchase was made to replace "non-compliant" PC's. However, no actions were taken to utilize Y2K conversion funds for the purchase, at that time.

- Of the $459,198.45 in PC costs proposed for transfer, included are purchases of 3-year extended warranties in the amount of $42,350. As indicated earlier in this report, expenditures on warranties are considered as routine maintenance costs and are not in accordance with spending criteria established in ETA's ET Handbook No. 336, 16th Edition or ETA Field Memorandum 47-99, dated July 14, 1999. Thus, transfers of expenditures on extended warranties should be considered an unallowable cost.

- In December of 1999 expenditures in the amount of $102,287.72 posted to the FY 1999 Y2K fund ledger were transferred to the FY 1998 Y2K fund ledger to exhaust remaining FY 1998 Y2K funds due to expire on December 31, 1999. This similar concept is now proposed to expend remaining FY 1999 Y2K funds. KPMG questions whether accounting transfers from other ledgers in lieu of expenditures via purchases satisfy DOL ETA's intent of placing expiration dates on fiscal year funds, particularly funds provided for emergency purposes such as the Y2K issue.

PA's Comments Regarding Remaining Unobligated FY1999 Funds

PA commented in response to KPMG's Draft Report dated June 1, 2001 that they strongly disagreed with the findings and recommendation to de-obligate the balance of remaining FY 1999 Y2K conversion funds. The Agency's comments are listed below:

> *The Pennsylvania Department of Labor and Industry's (PAL&I) desires to spend the remaining approximate $470,000 in FFY99 [FY1999] Y2K conversion funds through a combination of two ledger transfers; one for the purchase of personal computers (PC's) and the other for Y2K contracted services. Documentation of the proposed transactions and copies of the contracts involved were previously provided to the KPMG Audit Team (KPMG). Note that the remaining balance could rise with the inclusion of Y2K audit disallowances.*
>
> *KPMG had previously recommended that PAL&I obtain ETA Regional Office approval for these actions. PAL&I did this in a letter to Mr. Thomas Dowd, Regional Administrator, Employment and Training Administration dated May 23, 2001 (attached).*
>
> *In the latest Draft Y2K Audit Report KPMG raises concerns and recommends against the proposed use of the remaining Y2K Funds. PAL&I strongly disagrees with their assessment and recommendation for the following reasons:*
>
> 1) *KPMG does <u>not</u> question the fact that these PCs were not Y2K compliant and needed to be replaced prior to January 1, 2000.*
>
> 2) *KPMG questions the allowability of this purchase because the justification stated, " The requested resources will be utilized by the PA Job Centers to access the Career Development Marketplace Internet-Intranet System being implemented later this year. . . . Devices which are not "internet capable" must be replaced." As explained in our, May 23, 2001, letter to Mr. Dowd, PAL&I did not originally think that Y2K funds would be available for this purchase. Therefore, the Y2K readiness issue was not emphasized. Furthermore, PAL&I could not attach non-compliant PCs to the Network without jeopardizing Y2K readiness of the entire Network.*
>
> 3) *To subject the purchase of these PCs to the criteria proposed by KPMG requires that they meet a much tougher standard than that required of other remediation efforts. That standard appears to be: If a normally allowable Y2K remediation was also done for additional reasons, it is not allowable.*

4) *The KPMG questioned why funds for the replacement of these PC's were not included in Pennsylvania's SBR for FFY98 [FY1998]. The timeframe for submission of SBR's was very short. Pennsylvania's Job Center Field Operations (JCFO) was unable to obtain and compile data on the types and Y2K readiness of PC's in the 200 field locations before the prescribed federal deadline. Since the SBR amount allocated by USDOL to Pennsylvania was only 40% of requested and since USDOL guidance suggested that PC Y2K compliance be addressed lastly by PAL&I, we did not anticipate having Y2K funds available to replace the 550 non-compliant JCFO PC's. These unspent federal funds became available primarily due to the Commonwealth of Pennsylvania providing $3.5M in state funds for PAL&I related Y2K contract services and also helping to reduce our cost for final readiness testing. Since state Y2K funds were only to be used for contract services and not for hardware, regular ES federal funds were used to purchase these PC's. Although these expenditures were not included in PAL&I's SBR, they are Y2K related and are appropriate under the "bottom line authority" basis for Y2K funding provided to PAL&I in Mr. Edwin G. Strong, Regional Administrator's, January 13, 1998, grant award letter (attached) to PAL&I Secretary Johnny J. Butler.*

5) *Refusal to fund the purchase of these PCs would penalize PAL&I for following USDOL's instructions contained in the January 13, 1998, grant award letter that stated, "Before funds are spent on PC upgrades and replacements, mission critical systems need to be converted and tested for Y2K compliance."*

6) *KPMG stated, "The proposed transfers originate from expenses already incurred and posted against fiscal year funds that have expired. If the transfers are approved, a deficit in the FY1998 general funds ledger would be created. The resulting remaining balance would consist of expired funds and appear to be unusable for current expenses incurred. The State has not addressed the affect of this deficit." The exact ledgers the auditors were addressing with this comment are unclear. The PC's were purchased from our ES grant for FPY98. The movement of part of the costs for the purchase of these PC's would not create a deficit. It would create available funds in the ES grant for FPY98 against which allowable ES Program expenditures from FPY99 could then be offset. Even though the FPY98 ES grant is closed, the 3-year grant period will not expire until June 30th of 2001. PAL&I feels that the proposed ledger transfers are appropriate and meet USDOL guidelines and regulations.*

7) *Lastly, KPMG alleges that $42,350 of the proposed transfer would be for extended warranties and should be "considered an unallowable cost". These 550 PCs cost $862,400. Of that amount $42,350 was for the 3-year warranty. PAL&I agrees not to transfer any of this $42,350 to Y2K expenditure.*

KPMG's Analysis of PA's Comments Regarding Remaining Unobligated FY1999 Funds and Concluding Recommendation

At the conclusion of fieldwork, the remaining FY 1999 Y2K funds amounted to $459,198.45. In its response, PA correctly noted that the remaining balance will continue to rise as a result of ledger adjustments resulting from engagement findings. PA submitted a letter to Mr. Thomas Dowd, Regional Administrator, Employment and Training Administration on May 31, 2001, to request use of the remaining fund balance via proposed transfers of costs for PCs and contracted services.

PA has correctly noted that the affect of the two transfers would result in available remaining funds in the ES FPY1998 grants rather than a deficit. At the Exit Conference, we agreed to revise the report to reflect this fact. Language in the illustrative diagram embedded in the KPMG's Draft Report dated June 1, 2001 was modified accordingly. However, the narrative which should have also been modified, was not changed due to administrative oversight. The Final Report has been modified with the correction. In addition, KPMG's Draft Report dated June 1, 2001 referred to the "FY 1998 General Fund" as the fund from which the PC costs are proposed for transfer. Consistent with PA's reference to this fund ledger in its comments to our Draft Report, the fund is referred to as the "ES FPY 1998 Fund" in this Final Report.

Notwithstanding the language revisions, we still question the appropriateness of allowing the two proposed ledger transfers as a means of exhausting the remaining FY 1999 Y2K grants that are approaching expiration. The two transfers proposed by PA involve the FY 1998 Y2K ledger, which expired on December 31, 2000 and the ES FPY1998 ledger which expired on June 30, 2001. We note that PA performed similar transactions in December 2000 to use the remaining FY1998 Y2K grants prior to their expiration. In that case, they rolled back expenditures from the FY1999 Y2K ledger to the FY1998 ledger.

In its comments to KPMG's Draft Report dated June 1, 2001, PA responded that:

> *KPMG does not question the fact that these PCs were not Y2K compliant and needed to be replaced prior to January 1, 2000.*

KPMG did not assess the Y2K compliance status of the PCs during its review of the proposed transfers for the use of remaining FY1999 Y2K conversion funds. At the time that we received documentation on the proposed use of funds on April 12, 2001, the fieldwork had concluded. Therefore, PA should not have interpreted our silence on this issue as concurrence that the PCs were not Y2K compliant.

Further addressing comments by PA, we are not setting forth "tougher" standards for the purchase of these PCs proposed for transfer over requirements for other allowable Y2K purchases. As described in the justification in the Request to Acquire and noted in PA's comments, the old PCs were replaced because they were not "internet-capable" and were required to access the Career Development Marketplace Internet-Intranet System that was scheduled for implementation. The justification leads us to believe that replacement of the old "vintage" PCs, as described by PA, would have been included in established plans for implementing the new Internet-Intranet system. Therefore, it is unclear whether the primary purpose of the purchase was for Y2K reasons or if it was mainly for increased functionality. It is evident that the new system represented a change in the Agency's infrastructure and provided greatly expanded functionality. ETA in its March 5, 1999 SBR FY1999 award letter to PA, states:

> *If funding has been applied to replacement systems supporting new programs or new program initiatives, or to new system or networks providing greatly expanded functionality, then a portion of the these costs may be deemed unallowable.*

We suggest that consideration be given as to what the originating and primary need was for replacing these systems. If it is decided that there were Y2K reasons for the purchase, it should be determined whether complete replacement was required or if an upgrade was available.

Finally, on June 8, 1999, a memorandum was issued by the Director of the Office of Job Center Field Operations to the Agency's Y2K Coordinator stating that the purchased PC's replaced non-compliant PCs. However, the actual intent of this memorandum is not clearly defined. If the intent was to transfer the costs to the Y2K grant, it was not done. In our analysis of hardware purchases, we did find that PA requested and received approval to use available conversion funds to purchase 281 PCs in May of 2000 after mission-critical systems had been remediated. Not until approximately two years after issuance of the June 8, 1999 memorandum, when we requested documentation of the intended use of remaining funds, was there any action taken to use Y2K grant funds for the PC costs.

All of the issues identified in our analysis of PA's proposed transfer and response to KPMG's Draft Report dated June 1, 2001 have led us to question the appropriateness of the State's requested approval for use of remaining FY1999 Y2K conversion funds.

We recommend that the Assistant Secretary for Employment and Training carefully consider the intended purpose of providing State SESAs with emergency Y2K conversion funds when considering this issue. The Assistant Secretary should also consider if the transfer of costs from the already expired ES FPY1998 and FY1998 Y2K grants is an allowable means of expending the FY 1999 Y2K funds due which must be obligated by September 30, 2001 and expended by December 31, 2001. If the Assistant Secretary determines that the proposed transfers do not meet established criteria, then the remaining balance of FY 1999 Y2K conversion funds, adjusted for any recovered funds, should be deobligated.

CONCLUSION

ETA provided significant funds to assist PA with meeting its Y2K readiness requirements. Along with funding came specific requirements governing the use of these funds. We maintain our position that those questioned funds listed in this report and agreed to by the State of PA should be recovered by the Assistant Secretary for Employment and Training. In addition, ETA should carefully consider PA's proposed use of the remaining FY 1999 Y2K conversion funds.

RECOMMENDATIONS

We continue to recommend that the Assistant Secretary for Employment and Training recover a total of $246,261.50 in improperly charged or unsupported Y2K costs, net of any adjustments. The charges include:

- $115,047.78 expended on purchases that were not necessary to ensure Y2K readiness;
- $60,370.22 in salary and fringe benefit costs that either did not meet spending requirements or which were improperly calculated; and
- $70,843.50 of costs posted to the FY1999 fund ledger for *"Resources on Order"* which can not be supported as Y2K-related.

We further recommend that the Assistant Secretary deobligate the remaining FY 1999 Y2K funds of $459,158.45, as of February 28, 2001, adjusted for any recovered funds if the proposed costs for transfer do not meet ETA guidelines for expenditure of Y2K conversion funds.