

**STATE OF MARYLAND  
DEPARTMENT OF LABOR, LICENSING & REGULATION  
500 North Calvert Street  
Baltimore, Maryland 21202**

**LIMITED-SCOPE AUDIT OF  
MARYLAND'S DLLR  
ADP/IT CENTRAL SERVICES COSTS CHARGED  
TO U.S. DOL GRANTS IN  
OCTOBER 1996 THROUGH APRIL 2000**

**Final Report No: 03-01-002-03-315**

**Date Issued:**

**TICHENOR & ASSOCIATES, LLP  
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS**

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**FINAL REPORT**

**This audit was performed by Tichenor & Associates, LLP, under contract to the Office of Inspector General, and, by acceptance, it becomes a report of the Office of Inspector General.**

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**Assistant Inspector General for Audit  
U.S. Department of Labor**

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## EXECUTIVE SUMMARY

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Tichenor & Associates, LLP, under contract to the U.S. Department of Labor (DOL), Office of Inspector General (OIG), performed a limited-scope audit of the automatic data processing and information technology (ADP/IT) central services costs charged to DOL grant awards by the Maryland Department of Labor, Licensing and Regulation (DLLR) for Federal Fiscal Years (FFYs) 1997, 1998, 1999, and 2000 (through April 2000).

The initial objective of this limited-scope audit was to determine whether the ADP/IT central services costs charged to DOL Unemployment Insurance (UI) grants awarded to DLLR for FFY 1999 were reasonable, allowable, and allocable under the Federal cost principles set forth in Office of Management and Budget (OMB) Circular A-87, and the terms and conditions of the UI grant awarded to DLLR. At the request of the DOL/OIG, we subsequently expanded the scope of our audit to include all DOL grant awards to DLLR for FFYs 1997, 1998, 1999, and 2000 (through April 2000).

We were not engaged to, and did not, perform an audit of total costs charged to DOL grant awards by DLLR, the objective of which would have been the expression of an opinion on the total costs claimed by DLLR, and, accordingly, we do not express an opinion.

### AUDIT RESULTS

Based on the results of our audit, we question a total of \$1,339,695 in ADP/IT central services costs charged to DOL grant awards by DLLR during FFYs 1997, 1998, 1999, and 2000 (through April 2000) which do not comply with Federal cost principles. The total amount questioned includes \$1,222,020 in rebates not credited to DOL grant awards (Finding No. 1), and \$117,675 in unallowable interest costs charged to DOL grant awards (Finding No. 2).

Specifically, we found that DLLR had received ADP/IT central services rebates totaling \$1,272,783 from Annapolis Data Center (ADC) during FFYs 1998, 1999, and 2000 (through April 2000), of which \$1,222,020 (or more than 96 percent) were applicable to DOL grant awards. The rebates were necessary because the ADP/IT central services billing rates overcharged DOL grant awards during these years. However, DLLR did not credit these rebates to DOL grant awards as required by Federal cost principles.

In addition, we found that ADC periodically notified DLLR of the amount of unallowable interest costs on equipment acquisitions which had been included in its billings to DLLR. However, DLLR did not exclude these unallowable interest costs from the ADP/IT costs charged to the various DOL grant awards.

## RECOMMENDATIONS

We recommend that the cognizant DOL grant officers direct DLLR to credit the applicable Federal grants either as cost reductions or cash refunds, as appropriate, for:

- \$1,222,020 in rebates applicable to DOL grant awards which were received from ADC due to over-billings in FFYs 1998, 1999, and 2000 (through April 2000); and
- \$117,675 in unallowable interest costs included in ADC's billings for ADP/IT central services costs charged to DOL grant awards in FFYs 1997, 1998, 1999, and 2000 (through April 2000).

We also recommend that the Assistant Secretary for Employment and Training direct DLLR to implement internal control policies and procedures to ensure that costs claimed on DOL grant awards are "*net of all applicable credits*" as required by OMB Circular A-87.

In addition, we recommend that the Assistant Secretary for Employment and Training direct DLLR to implement internal control policies and procedures to ensure that all unallowable interest costs are eliminated from the costs claimed for reimbursement under its DOL grant awards as required by OMB Circular A-87.

## AUDITEE'S RESPONSE

In a letter dated January 19, 2001, DLLR stated that it agreed with the findings presented in our draft audit report dated December 21, 2000, and that all monies in question had been credited to the appropriate Federal grant awards as of September 2000. Attached to DLLR's response were a number of journal vouchers showing accounting entries made in DLLR's accounting records to credit the rebates and unallowable interest costs to the DOL grant awards.

DLLR also stated that: (1) it had implemented internal control policies and procedures to insure that similar funds would be handled properly in the future; and (2) it was in the process of adding additional staff to the Office of Budget and Fiscal Services to handle the accounting for Federal funds. DLLR's written comments are discussed in more detail in each of our findings. The full text of DLLR's response has been included at the end of this report.

## AUDITOR'S CONCLUSION

During our followup of corrective actions reported by DLLR's, we were provided with documentation showing that DLLR had prepared a number of journal vouchers which would result in credits to various DOL grant awards in its accounting records for: (1) the various rebates received from the ADC; and (2) the unallowable interest costs included in the ADP/IT central services costs charged to DOL grants. In some instances, these journal entries were reversed out and re-entered one or more times because

DLLR was uncertain about whether the methodologies used to allocate the credits to DOL grant awards were appropriate.

In response to our queries, DLLR officials acknowledge that although these credits had been recorded in their accounting records, they had not yet been credited to DOL in the form of cash refunds and/or reduced expenditures on DLLR's quarterly Financial Status Reports as of January 31, 2001. The DLLR officials stated they were in the process of working with DOL program officials to determine the best way to pass these credits on to DOL.

OIG concurs with DLLR's response and considers these recommendations resolved. To close these recommendations, DLLR must provide documentation to OIG to ensure that: (1) DOL actually received proper credit in the form of reduced expenditures and/or cash refunds for the rebates and the unallowable interest costs as required by OMB Circular A-87; and (2) the new internal control procedures being implemented by DLLR will properly account for all credit transactions, including rebates and unallowable interest costs.

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## ACRONYMS

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ADP/IT	Automatic Data Processing/Information Technology
ADC	State of Maryland, Annapolis Data Center
BLS	Bureau of Labor Statistics
DLLR	State of Maryland, Department of Labor, Licensing and Regulation
DOL	U.S. Department of Labor
ES	Employment Service
ETA	Employment and Training Administration
FFY	Federal Fiscal Year
FSR	Financial Status Report
HHS	U.S. Department of Health and Human Services
OCD	U.S. Department of Labor, Office of Cost Determination
OIG	Office of Inspector General
OMB	U.S. Office of Management and Budget
SWCAP	Statewide Cost Allocation Plan
UI	Unemployment Insurance
VETS	Veterans Employment and Training Service



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## INTRODUCTION

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### BACKGROUND

The State of Maryland's Department of Labor, Licensing and Regulation (DLLR) receives substantial Federal funding annually from various U.S. Department of Labor (DOL) agencies, including Bureau of Labor Statistics (BLS), Employment Service (ES), Employment and Training Administration (ETA), and Veterans Employment and Training Service (VETS). ETA's Unemployment Insurance (UI) program accounts for more than 60 percent of DLLR's total Federal funding.

ETA has expressed concern that state (UI) programs which obtain automatic data processing and information technology (ADP/IT) services from outside the UI agency tend to have extraordinary costs compared with state UI programs which have their own ADP/IT capabilities. Accordingly, ETA has requested that DOL, Office of Inspector General (OIG), consider this matter in planning future audit work.

Although Maryland's UI program has its own staff of computer programmers, it procures its computer mainframe ADP/IT central services from Annapolis Data Center (ADC). ADC is a service bureau providing ADP/IT central services to agencies and departments of the executive and legislative branches of the Maryland State government. It is operated by the Information Technology Division in the Maryland Office of the Comptroller. ADC provides mainframe computer services for nine primary and fifteen secondary user agencies in the State of Maryland. ADC's operational costs are fully reimbursable from customer agencies via a charge-back billing which produces a monthly invoice for computer usage and services rendered.

### OBJECTIVES AND SCOPE

The primary objective of this limited-scope audit was to determine whether the ADP/IT central services costs charged to the Maryland UI for FFY 1999 were reasonable, allowable, and properly allocable to the UI program under the Federal cost principles set forth in Office of Management and Budget (OMB) Circular A-87, and the terms and conditions of the UI grant awarded to Maryland's DLLR. At the request of the DOL/OIG, we subsequently expanded the scope of our audit to include all DOL grant awards to DLLR for FFYs 1997, 1998, 1999, and 2000 (through April 2000).

We were not engaged to, and did not, perform an audit of total costs charged to DOL grant awards by DLLR, the objective of which would have been the expression of an opinion on the total costs claimed by DLLR, and, accordingly, we do not express an opinion.

Our limited-scope audit was performed in accordance with applicable standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards* issued by the Controller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of DLLR's total claimed costs, the adequacy of its system of internal controls, or its compliance with laws and regulations applicable to Federal grant awards.

The audit fieldwork for this engagement was conducted at ADC in Annapolis, Maryland, and at DLLR offices in Baltimore, Maryland, during the period July-September, 2000. We held an exit conference with DLLR officials on September 21, 2000.

## **FEDERAL COST PRINCIPLES**

OMB Circular A-102 entitled "*Grants and Cooperative Agreements with State and Local Governments*" sets forth Government-wide minimum uniform administrative requirements and conditions which must be met by state and local governments which receive Federal financial assistance, including standards for financial management systems. DOL has implemented these requirements at Title 29, Code of Federal Regulations, Part 97. Both documents require that state and local governments comply with the cost principles set forth in OMB Circular A-87 entitled "*Cost Principles for State, Local and Indian Tribal Governments*" in determining allowable costs.

Among other things, OMB Circular A-87 contains both general principles for determining allowable costs (Attachment A) and specific guidelines for determining the allowability of selected items of cost (Attachment B). The following cost principles are relevant to this particular report.

Attachment A, Paragraph C.1. *To be allowable under Federal awards, costs must meet the following general criteria(:) i. Be the net of all applicable credits.* [Emphasis added.]

Attachment A, Paragraph C.4.a. *Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.* [Emphasis added.]

Attachment A, Paragraph D.1. *The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.* [Emphasis added.]

Attachment B, Paragraph 26.a. *Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.* [Emphasis added.]

Attachment B, Paragraph 26.b. *Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1)-(4).*

*(1) The financing is provided . . . by a bona fide third party external to the governmental unit.* [Emphasis added.]

Finally, internal control standards issued by the U.S. General Accounting Office, *Standards for Internal Control in the Federal Government*, establish minimum acceptable levels of quality control systems for Federal programs and activities. Some specific standards include:

- **Documentation.** All transactions and other significant events should be clearly documented, and the documentation should be readily available for examination. Such documentation should be complete and accurate and should facilitate tracing the transaction or event and related information from its beginning, while it is in process, and until after it has been completed.
- **Recording of Transactions and Events.** Transactions and other significant events must be promptly recorded and properly classified. This standard applies to (1) the entire process or life cycle of a transaction or significant event and includes the initiation and authorization; (2) all aspects of the transaction or event while in process; and (3) its final classification in summary records.
- **Execution of Transactions and Events.** Transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority.

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## FINDINGS AND RECOMMENDATIONS

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Based on the results of our audit, we question a total of \$1,339,695 in ADP/IT central services costs charged to DOL grant awards by DLLR during FFYs 1997, 1998, 1999, and 2000 (through April 2000).

Our audit disclosed that, although the ADP/IT costs billed to DLLR by ADC were generally charged to DOL grant awards on the basis of relative benefits received, DLLR did not credit DOL grant awards with the rebates received from ADC as required by OMB Circular A-87. Periodically, ADC issued rebates to its various user organizations on a pro rata basis as a result of over-billings during each year. During FFYs 1998, 1999, and 2000 (through April 2000), DLLR received rebates from ADC totaling \$1,272,783 of which \$1,222,020 (or more than 96 percent) was applicable to DOL grant awards. (See Exhibit D.)

In addition, we found that ADC sent out memoranda to each of its state user organizations informing them of interest costs included in their respective billings and notified them of the need to comply with Federal cost principles for ADP/IT costs charged to federally funded programs. However, DLLR failed to take action to exclude the unallowable interest costs from Financial Status Reports (FSRs) on its various DOL grant awards. Our audit disclosed that ADC billings to DLLR included unallowable interest costs totaling \$121,840 during FFYs 1997, 1998, 1999, and 2000 (through April 2000), of which \$117,675 (or 96.58 percent) was charged to DOL grant awards in violation of OMB Circular A-87. (See Exhibit E.)

Based on our audit, we concluded that these problems were attributable, at least in part, to the fact that DLLR had not established internal control procedures to ensure that costs claimed on the quarterly FSRs fully complied with the Federal cost principles set forth in OMB Circular A-87.

### **1. Uncredited Rebates Over \$1.2 Million**

DLLR received periodic rebates totaling \$1,272,783 from ADC during FFYs 1998, 1999, and 2000 (through April 30, 2000) caused by over-billings for ADP/IT central services costs. Our audit disclosed that \$1,222,020 (or more than 96 percent) of the total rebates was allocable to various DOL grant awards. However, DLLR failed to credit the rebates to the various DOL grant awards to which they were allocable as required by OMB Circular A-87.

OMB Circular A-87 (revised May 4, 1995) establishes principles and standards for determining allowable costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments and federally recognized Indian tribal governments. The

Circular states in Attachment A, paragraph C.1., that to be allowable under Federal awards, costs must meet certain general criteria including, among other things, “*Be the net of all applicable credits.*” The Circular also states in Attachment A, paragraph C.4.a. that:

*Applicable credits refer to those receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, . . . and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate. [Emphasis added.]*

In addition, the Circular states in Attachment A, paragraph D.1. that: “*The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.*” [Emphasis added.]

Our fieldwork at ADC disclosed, and ADC officials confirmed, that the ADC cost allocation plan used to establish billing rates for the various central services it provides to state agencies will generally result in the user organizations being over-billed during the year based on the assumption that it would be easier to rebate the amounts overcharged than it was to try to recover any under-billings through additional charges at the end of each year. The charge-back system is based on a cost allocation plan prepared annually and approved by the Maryland Department of Budget and Management.

We found that ADC had issued four rebates to DLLR totaling \$1,272,783 in FFYs 1998, 1999, and 2000 (through April 2000) as a result of its over-billings for ADP/IT central services costs during these periods. The total amount of the rebates in each year represents DLLR’s pro rata share of the excess of total ADC’s annual billings over its total actual costs for each year. The rebates to the various state user organizations were made on a lump sum basis, and do not reflect the amounts applicable to individual Federal grant awards. ADC officials track billings by state user organizations — not by individual Federal grant awards — because only the user organizations have the information needed to tie specific ADP/IT projects and services provided by ADC to specific Federal grant awards. Therefore, our fieldwork at DLLR focused primarily on determining how DLLR allocated the total ADC billings and the corresponding rebates to its various cost objectives.

Our audit disclosed that DLLR used a two-tier methodology for allocating and charging the monthly ADC billings to the various benefitting cost objectives which generally complied with the requirements set forth in OMB Circular A-87. First, using a large computer printout which accompanied (and supported) the monthly ADC invoice, DLLR identified all ADC services and projects performed on behalf of DLLR Office of Budget and Fiscal Services. The costs of these indirect services and projects were then allocated to all DLLR final cost objectives on the basis of total authorized positions. Second,

the costs of the remaining ADC services and projects were then directly charged to the benefitting final cost objectives.

However, when we asked DLLR officials about the methodology used to allocate ADC rebates to its various cost objectives (including Federal grant awards), DLLR officials stated that they had not allocated the rebates or reduced the Federal grant expenditures claimed for reimbursement on the quarterly FSRs (SF-269s).

Our audit disclosed that DLLR does not have internal control procedures to ensure that costs claimed on the quarterly FSRs Reports for its various Federal grant awards were “*net of all applicable credits*” as required by OMB Circular A-87. Specifically, when we inquired about the policies and procedures established by DLLR to ensure that all credits (e.g., ADC rebates) were either used as “*a cost reduction*” on the SF-269s or a “*cash refund*” as required by OMB Circular A-87, a DLLR official stated that when they received the rebate paperwork from ADC, they were unclear about how to handle the rebate, so nothing was done.

Because DLLR did not apply the rebates received from ADC as credits to appropriate Federal grants, these DOL grant awards for FFYs 1998, 1999, and 2000 (through April 30, 2000) were overstated by a total of \$1,222,020, as follows:

Federal Fiscal Year	Date of Rebate	Total Rebate to DLLR	DOL Share of Rebate	
			Amount	Percent
1998	7/9/98	\$ 165,109	\$ 160,040	96.93%
1999	4/27/99	226,428	216,805	95.75% <sup>1</sup>
1999	7/7/99	517,702	495,700	95.75% <sup>1</sup>
2000	4/21/00	363,544	349,475	96.13%
	<b>Totals</b>	<b>\$1,272,783</b>	<b>\$1,222,020</b>	<b>96.01%</b>

Note 1: Exhibit B shows the total DOL share of the rebate in FFY 1999 as 95.74 percent. This 1/100th of a percentage point is due to rounding in our computerized spreadsheets, and does not materially affect our calculations.

We calculated DOL’s percentage share of each rebate by summarizing DLLR’s allocation of total ADC billings to its various Federal and state cost objectives for FFYs 1998, 1999, and 2000 (through April 30, 2000). We also determined percentages by applicable DOL program offices (e.g., BLS, ES, ETA, UI, and VETS), state programs, and three program cost centers for which the specific funding sources were unknown. (See Exhibits A, B, and C.)



## Recommendations

1a. We recommend that the cognizant DOL Grant Officers direct DLLR to credit the applicable Federal grants either as cost reductions, or cash refunds, as appropriate, for \$1,222,020 in rebates applicable to DOL grant awards which were received from ADC due to over-billings in FFYs 1998, 1999, and 2000 (through April 2000) as follows:

• Bureau of Labor Statistics	\$ 3,067
• Employment Service	257,902
• Employment and Training Administration	1,843
• Unemployment Insurance	891,132
• Veterans Employment and Training Service	58,058
• Adjustment Due to Spreadsheet Rounding	<u>\$18</u>
Total	<u>\$1,222,020</u>

(See Exhibit D for details.)

1b. We also recommend that the Assistant Secretary for Employment and Training direct DLLR to implement internal control policies and procedures to ensure that costs claimed on DOL grant awards are “*net of all applicable credits*” as required by OMB Circular A-87.

## Auditee’s Response

In a letter dated January 19, 2001, DLLR stated that it agreed with the findings presented in our draft report, and that all monies in question had been credited to the appropriate Federal grant awards as of September 2000. DLLR acknowledged that, at least for the past 4 years, the ADC had been overcharging its state user organizations for ADP/IT services, and then rebating the excess billings at some point during the year. Rather than directing these credits to DLLR’s Office of Budget and Fiscal Services, ADC sent them to DLLR’s Office of Information Technology where they were credited to its Computer Usage – Annapolis Data Center account.

DLLR stated that the first rebate listed on page 6 of our draft report, in the amount of \$165,109 (of which we had determined that \$160,040 was DOL’s share), was credited to its Office of Information Technology on July 9, 1998, and distributed out to the appropriate programs on July 29, 1998. The remaining rebates received in 1999 and 2000 were not distributed until September 2000.

DLLR stated that it has notified the ADC to send all future rebate credits directly to the Director of the Office of Budget and Fiscal Services. In addition, DLLR has set up a system in the Office of Budget and Fiscal Services to monitor the receipt of these rebates and to credit them to the appropriate DLLR programs within one month of receipt. DLLR further stated that it has provided training to ensure that all personnel responsible for Federal grant costs have an understanding of the cost principles set forth in



OMB Circular A-87, and that DLLR has established internal control procedures to ensure that costs claimed on the quarterly financial status reports for Federal Grants are “*net of all applicable credits*,” as required by OMB Circular A-87.

Finally, DLLR stated in its response that, as of September 30, 2000, \$1,858,462 in rebates had been credited to Federal grants, including all rebates from 1997 through 2000. DLLR said it had provided documentation supporting these credits and the allocation process to the auditors in November 2000, and that this documentation remains available in the Office of Budget and Fiscal Services.

### **Auditor’s Conclusion**

During our followup on the corrective actions reported by DLLR in its January 19, 2001, response, we were provided with documentation showing that DLLR had prepared a number of journal vouchers which would result in credits to various DOL grant awards in its accounting records for the various rebates it had received from the ADC. We were also provided with documentation showing that these journal entries were reversed out and revised one or more times for each of the rebates. According to DLLR officials, these multiple adjustments occurred because of uncertainties about whether the methodologies used to allocate the rebate credits to DOL grant awards were appropriate.

In response to our queries, DLLR officials acknowledged that, although rebate credits had been recorded in their accounting records, they had not been credited to DOL in the form of cash refunds or reduced expenditures on DLLR’s quarterly Financial Status Reports as of January 31, 2001. They stated that they were in the process of working with DOL program officials to determine the best way to pass these credits on to DOL.

Although our audit focused only on the rebates received by DLLR in 1998, 1999, and 2000, DLLR is correct in including the 1997 rebates (totaling about \$585,000) in the corrective actions it is taking. This increases the total to \$1,858,462 in rebates received by DLLR during 1997 through 2000 (through April 30, 2000) — not the amount credited to Federal grants as represented in DLLR’s response. DLLR officials stated that they are in the process of determining the exact amounts of rebates to be credited to each grant in each fiscal year.

OIG concurs with DLLR’s response and considers these recommendations resolved. To close these recommendations, DLLR must provide documentation to OIG to ensure that: (1) DOL actually received proper credit for the rebates in the form of cash refunds and/or reduced expenditures, as required by OMB Circular A-87; and (2) the new internal control procedures being implemented by DLLR will properly account for all credit transactions.

## 2. Unallowable Interest Costs Over \$117,000

ADC periodically sends memoranda to each of its state user organizations informing them of the interest costs included in their respective billings for ADP/IT central services costs, and informing them of their need to comply with Federal cost principles for ADP/IT costs in federally funded programs. We determined those ADC billings to DLLR for FFYs 1997, 1998, 1999, and 2000 (through April 2000) included unallowable interest costs totaling \$121,840, of which \$117,675 (or 96.58 percent) was charged to DOL grant awards in violation of OMB Circular A-87.

OMB Circular A-87, Attachment B, provides specific criteria and guidelines to grantees regarding the allowability of selected items of costs. Paragraph 26 of Attachment B states that:

*a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.* [Emphasis added.]

*b. Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1)-(4).*

*(1) The financing is provided . . . by a bona fide third party external to the governmental unit.* [Emphasis added.]

During our fieldwork at ADC, we found that interest costs on ADP equipment acquisitions were included in the total ADC costs used in its cost allocation plans to calculate its billing rates. In response to our query about why the unallowable interest costs had not been excluded from its billing rates, an ADC official stated that ADC was operated as a service bureau for state agencies and that its costs were fully reimbursable from the user agencies via a charge-back billing system. He stated that ADC sends a memorandum at least annually to each state user organization reporting the dollar amount of interest cost included in its billings for that year. These memoranda instruct the user organizations that they may have to eliminate the interest costs when reporting costs under their various Federal grant awards.

Our audit disclosed that ADC did not finance any of its equipment acquisitions directly with bona fide third-party lending institutions. Thus, the interest costs included in its billing rates are unallowable.

In addition, during our fieldwork at DLLR, we followed up to determine whether the unallowable interest costs periodically reported by ADC had been excluded from the total costs claimed for reimbursement by DLLR in the quarterly FSRs on its various Federal grant awards. DLLR officials acknowledged that they had taken no action to eliminate the interest costs reported by ADC from the total costs charged by DLLR to its various Federal grant awards.

Our audit disclosed that DLLR does not have internal control procedures to ensure that the unallowable interest costs included in ADC billings for ADP/IT central services costs were excluded from the costs charged by DLLR in the quarterly FSRs.

In response to our queries about why the unallowable interest costs were not excluded from the ADP/IT costs charged to the various DOL grant awards, DLLR officials initially told us that they had never received any correspondence from ADC regarding unallowable interest costs. However, when we pointed out that we had found one of the ADC interest memoranda in DLLR's file of monthly invoices received from ADC for ADP/IT central services billing, DLLR officials said that they were unclear about how to handle such memoranda, so nothing was done.

Because DLLR did not eliminate the unallowable interest costs included in the ADP/IT costs billed by ADC for FFYs 1997, 1998, 1999, and 2000 (through April 30, 2000), the DOL grant awards were overstated by a total of \$117,675, as follows:

Federal Fiscal Year	Interest Memo Issued by Quarter	Total Unallowable Interest Reported to DLLR	Share of Unallowable Interest Charged to DOL	
			Amount	Percent
1997	1 <sup>st</sup>	\$ 25,604	\$ 24,818	96.93%
1997	3 <sup>rd</sup>	26,459	25,647	96.93%
1998	3 <sup>rd</sup>	30,291	29,361	96.93%
1999	3 <sup>rd</sup>	28,556	27,342	95.75% <sup>1</sup>
2000	2 <sup>nd</sup>	10,930	10,507	96.13%
	<b>Totals</b>	<b>\$121,840</b>	<b>\$117,675</b>	<b>96.58%</b>

Note 1: Exhibit B shows the total DOL share of the rebate in FFY 1999 as 95.74 percent. This 1/100th of a percentage point results from rounding in our computerized spreadsheets, and does not materially affect our calculations.

We calculated the amount of unallowable interest costs charged to DOL programs by summarizing DLLR's allocation of total ADC billings to its various Federal and state cost objectives, as discussed in the preceding finding. We also determined the percentages applicable to individual DOL program offices (e.g., BLS, ES ETA, UI, and VETS). (See Exhibit E.)

## Recommendations

2a. We recommend that the cognizant DOL Grant Officers direct DLLR to credit the applicable Federal grants either as cost reductions, or cash refunds, as appropriate, for \$117,675 in unallowable interest costs included in ADC's billings for ADP/IT central services costs charged to DOL grant awards in FFYs 1997, 1998, 1999, and 2000 (through April 2000), as follows:

• Bureau of Labor Statistics	\$ 1,311
• Employment Service	23,443
• Employment and Training Administration	133
• Unemployment Insurance	88,189
• Veterans Employment and Training Service	4,591
• Adjustment Due to Spreadsheet Rounding	<u>8</u>
Total	<u>\$117,675</u>

(See Exhibit E for details.)

2b. We recommend that the Assistant Secretary for Employment and Training direct DLLR to implement internal control policies and procedures to ensure that all unallowable interest costs are eliminated from the costs claimed for reimbursement under its DOL grant awards as required by OMB Circular A-87.

## Auditee's Response

In its letter dated January 19, 2001, DLLR stated that it agreed with the findings presented in our draft report. DLLR stated that up until the time of the audit, there had not been a procedure within the Office of Budget and Fiscal Services to deduct unallowable interest costs from the ADC charges made to the Federal programs. While notices were apparently sent by ADC to DLLR informing it of the amount of the interest costs, these notices were not directed to the Director of the Office of Budget and Fiscal Services, and were not acted on by the individuals who processed the billings.

DLLR said that it has requested that the ADC send all communications regarding billings, credits, and interest to the attention of the Director of the Office of Budget and Fiscal Services to ensure that they are given to the appropriate personnel for processing. The individuals who handle the accounting for these monies have been trained so that they can identify unallowable costs, and make the necessary deductions from the charges to Federal grant programs. Also, internal control policies and procedures have been established to ensure that all unallowable costs included in the ADC billings will be excluded from the costs claimed by DLLR under its DOL grant awards.

In addition, DLLR said it had reimbursed the budgets of the Federal programs which have been charged with unallowable interest costs in a total amount of \$121,840. Documentation supporting these reimbursements was provided to the auditors in November 2000 and remains available for inspection in the Office of Budget and Fiscal Services.

## **Auditor's Conclusion**

During our followup on the corrective actions reported by DLLR in its January 19, 2001, response, we were provided with documentation showing that DLLR had prepared several journal vouchers which would result in credits to various DOL grant awards in its accounting records for the unallowable interest costs included in its ADC billings for 1997, 1998, 1999, and 2000 (through April 2000).

In response to our queries, DLLR officials acknowledged that, although the credits for unallowable interest costs had been recorded in their accounting records, these credits had not been credited to DOL in the form of cash refunds, or reduced expenditures on DLLR's quarterly Financial Status Reports as of January 31, 2001. DLLR stated that they were in the process of working with DOL program officials to determine the best way to pass these credits on to DOL.

DLLR is incorrect in its statement that it has reimbursed the budgets of the Federal programs which were charged with unallowable interest costs of \$121,840. This amount represents the total amount of unallowable interest costs included in the ADC billings to DLLR during the period 1997 through April 2000 — not the amount credited to Federal grants.

OIG concurs with DLLR's response and considers these recommendations resolved. To close these recommendations DLLR must provide documentation to OIG to ensure that: (1) DOL actually received proper credit for the unallowable interest costs in the form of cash refunds and/or reduced expenditures, as required by OMB Circular A-87; and (2) the new internal control procedures being implemented by DLLR verify that unallowable costs are excluded from total grant costs submitted to DOL.

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Assistant Inspector General for Audit  
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U.S. Department of Labor  
200 Constitution Ave., NW  
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**INDEPENDENT ACCOUNTANT'S REPORT ON AUDIT**

Tichenor & Associates, LLP, was engaged by the Office of Inspector General (OIG), U.S. Department of Labor (DOL), to conduct a limited-scope audit of the automatic data processing and information technology (ADP/IT) central services costs charged to grants awarded to the State of Maryland's Department of Labor, Licensing and Regulation (DLLR) for Federal fiscal years (FFYs) 1997, 1998, 1999, and 2000 (through April 2000).

The initial objective of this limited-scope audit was to determine whether the ADP/IT central services costs charged to DOL Unemployment Insurance (UI) grants awarded to DLLR for FFY 1999 were reasonable, allowable, and allocable under the Federal cost principles set forth in Office of Management and Budget (OMB) Circular A-87, and the terms and conditions of the UI grant awarded to DLLR. However, at the request of the DOL/OIG, we subsequently expanded the scope of our audit to include all DOL grant awards to DLLR for FFYs 1997, 1998, 1999, and 2000 (through April 2000).

We were not engaged to, and did not, perform an audit of total costs charged to DOL grant awards by DLLR, the objective of which would have been the expression of an opinion on the total costs claimed by DLLR, and, accordingly, we do not express an opinion.

Based on the results of our audit, we questioned a total of \$1,339,695 in ADP/IT central services costs charged to DOL grant awards by DLLR during FFY 1997, 1998, 1999, and 2000 (through April 2000) which were not in compliance with the Federal costs principles mandated by OMB Circular A-87. Specifically, we found that DLLR had received ADP/IT central services cost rebates totaling \$1,272,783 during FFYs 1998, 1999, and 2000 (through April 2000) of which \$1,222,020 (or more than 96 percent) were applicable to DOL grant awards; however, DLLR

failed to credit these rebates to DOL grant awards as required by Federal cost principles. In addition, we found that DLLR was notified that its ADP/IT central services billings for FFYs 1997, 1998, 1999, and 2000 (through April 2000) included unallowable interest costs totaling \$121,840; however, DLLR took no action to exclude \$117,675 in unallowable interest costs included in the ADP/IT central services costs charged to its various DOL grant awards as required by Federal cost principles.

This limited-scope audit was performed in accordance with applicable standards established by the American Institute of Certified Public Accountants, and the *Government Auditing Standards* issued by the Controller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of DLLR's total claimed costs, the adequacy of its overall system of internal controls, or its compliance with laws and regulations applicable to Federal grant awards. Our detailed findings, conclusions, and recommendations are contained in the accompanying report.

This report is intended solely for the use of the U.S. Department of Labor; however, the final report is a matter of public record and its distribution is not limited.

TICHENOR & ASSOCIATES, LLP  
Woodbridge, Virginia  
November 15, 2000

## **EXHIBITS**



## Schedule of Final Distribution of ADP/IT Central Services Charges to DLLR for FFY 1998

Funding Source	Organization	FFY 1998 DLLR Total Allocation of ADC Charges	Percentage Share		
			DOL	State	Other
BLS	Labor Market analysis - CES	\$ 1,885.95	0.14%		
BLS	Labor Market Analysis - ES 202	12,976.11	0.94%		
	Subtotals	\$14,862.06	1.07%		
ES	Alien Labor Certification	\$13,003.09	0.94%		
ES	WOTC/TJTC	48,378.35	3.50%		
ES	Job Service (10%)	689.33	0.05%		
ES	Job Service (Wagner-Peyser) 90%	196,082.37	14.17%		
	Subtotals	\$258,153.14	18.66%		
ETA	EDWAA	\$333.15	0.02%		
ETA	JTPA (OET)	932.84	0.07%		
	Subtotals	\$1,265.99	0.09%		
UI	UI Quality Control/Random Audit	\$3,049.92	0.22%		
UI	Labor Market Analysis - Admin.	2,465.38	0.18%		
UI	Appeals Division	6,175.85	0.45%		
UI	UI Alien Verification Save	0.00	0.00%		
UI	UI Benefit System Redesign-MABS	815,725.58	58.96%		
UI	Office of Information Technology	3,731.39	0.27%		
UI	Unemployment Insurance	190,903.63	13.80%		
UI	UI Child Support	44.96	0.00%		
	Subtotals	\$1,022,096.71	73.88%		
VETS	DVOP	\$26,403.97	1.81%		
VETS	LVER	18,177.56	1.31%		
	Subtotals	\$44,581.53	3.22%		
State	Labor and Industry	\$12,843.36		0.93%	
State	Office of the Secretary	16,192.10		1.17%	
State	Occupational & Professional	5,597.09		0.40%	
State	Licensing	4,161.18		0.30%	
State	Division of Racing	2,798.54		0.20%	
	Subtotals	\$41,592.27		3.01%	
unknown (1)	Assistant Secretary - DET	\$533.05			0.04%
unknown (2)	MOICC - Admin	266.55			0.02%
unknown (3)	CareerNet	66.61			0.00%
	Subtotals	\$866.21			0.06%
Percentage Subtotals by Agency			96.93%	3.01%	0.06%
Totals		\$1,383,417.91			100.00 %

## Notes:

(1) According to DLLR officials, these charges are shared by three DOL programs (Labor Market Analysis, Job Service, and UI). However, they were unable to tell us how much was charged to each of the three programs.

(2) DLLR officials were unable to identify the funding source for these costs. Our review indicates that these costs are probably being funded through the U.S. Department of Education.

(3) DLLR officials were unable to identify the funding source for these costs. There are indications that it was funded through Job Service, but DLLR officials were unable to confirm this information.

## Schedule of Final Distribution of ADP/IT Central Services Charges to DLLR for FFY 1999

Funding Source	Organization	FFY 1999 DLLR Total Allocation of ADC Charges	Percentage Share		
			DOL	State	Other
BLS	Labor Market analysis - CES	\$ 836.07	0.05%		
BLS	Labor Market Analysis - ES 202	23,952.15	1.41%		
	Subtotals	\$24,788.22	1.46%		
ES	Alien Labor Certification	\$26,244.84	1.54%		
ES	WOTC/TJTC	95,284.33	5.59%		
ES	Job Service (10%)	1,046.36	0.06%		
ES	Job Service (Wagner-Peyser) 90%	221,293.54	12.99%		
	Subtotals	\$343,869.07	20.19%		
ETA	EDWAA	\$569.65	0.03%		
ETA	JTPA (OET)	1,595.00	0.09%		
	Subtotals	\$2,164.65	0.13%		
UI	UI Quality Control/Random Audit	\$3,589.75	0.21%		
UI	Labor Market Analysis - Admin.	4,215.36	0.25%		
UI	Appeals Division	8,621.90	0.51%		
UI	UI Alien Verification Save	0.00	0.00%		
UI	UI Benefit System Redesign-MABS	389,915.36	22.89%		
UI	Office of Information Technology	6,379.99	0.37%		
UI	Unemployment Insurance	750,032.46	44.03%		
UI	UI Child Support	45.72	0.00%		
	Subtotals	\$1,162,800.54	68.26%		
VETS	DVOP	\$57,722.18	3.39%		
VETS	LVER	39,483.59	2.32%		
	Subtotals	\$97,205.77	5.71%		
State	Labor and Industry	\$21,959.71		1.29%	
State	Office of the Secretary	27,684.60		1.63%	
State	Occupational & Professional	9,569.99		0.56%	
State	Licensing	7,114.82		0.42%	
State	Division of Racing	4,784.99		0.28%	
	Subtotals	\$71,114.11		4.17%	
unknown (1)	Assistant Secretary - DET	\$911.42			0.05%
unknown (2)	MOICC - Admin	455.71			0.03%
unknown (3)	CareerNet	113.94			0.01%
	Subtotals	\$1,481.07			0.09%
Percentage Subtotals by Agency			95.74%	4.17%	0.09%
Totals		\$1,703,423.43			100.00 %

## Notes:

(1) According to DLLR officials, these charges are shared by three DOL programs (Labor Market Analysis, Job Service, and UI). However, they were unable to tell us how much was charged to each of the three programs.

(2) DLLR officials were unable to identify the funding source for these costs. Our review indicates that these costs are probably being funded through the U.S. Department of Education.

(3) DLLR officials were unable to identify the funding source for these costs. There are indications that it was funded through Job Service, but DLLR officials were unable to confirm this information.

**Schedule of Final Distribution of ADP/IT Central Services Charges to DLLR for FFY 2000  
(through April 2000)**

Funding Source	Organization	FFY 2000 DLLR Total Allocation of ADC Charges	Percentage Share		
			DOL	State	Other
BLS	Labor Market analysis - CES	\$ 65.70	0.01%		
BLS	Labor Market Analysis - ES 202	980.24	0.11%		
	Subtotals	\$1,045.94	0.12%		
ES	Alien Labor Certification	\$6,947.37	0.81%		
ES	WOTC/TJTC	53,334.46	6.24%		
ES	Job Service (10%)	411.38	0.05%		
ES	Job Service (Wagner-Peyser) 90%	119,963.79	14.03%		
	Subtotals	\$180,657.00	21.14%		
ETA	EDWAA	\$790.38	0.09%		
ETA	JTPA (OET)	936.25	0.11%		
	Subtotals	\$1,726.63	0.20%		
UI	UI Quality Control/Random Audit	\$1,445.73	0.17%		
UI	Labor Market Analysis - Admin.	1,924.53	0.23%		
UI	Appeals Division	4,336.09	0.51%		
UI	UI Alien Verification Save	0.00	0.00%		
UI	UI Benefit System Redesign-MABS	200,943.04	23.51%		
UI	Office of Information Technology	2,849.75	0.33%		
UI	Unemployment Insurance	402,610.77	47.10%		
UI	UI Child Support	12.14	0.00%		
	Subtotals	\$614,122.05	71.85%		
VETS	DVOP	\$13,393.24	1.57%		
VETS	LVER	10,747.30	1.26%		
	Subtotals	\$24,140.54	2.82%		
State	Labor and Industry	\$10,766.99		1.26%	
State	Office of the Secretary	12,817.65		1.50%	
State	Occupational & Professional	4,265.18		0.50%	
State	Licensing	1,664.45		0.19%	
State	Division of Racing	2,964.83		0.35%	
	Subtotals	\$32,479.10		3.80%	
unknown (1)	Assistant Secretary - DET	\$421.64			0.05%
unknown (2)	MOICC - Admin	156.05			0.02%
unknown (3)	CareerNet	0.00			0.00%
	Subtotals	\$577.69			0.07%
Percentage Subtotals by Agency			96.13%	3.80%	0.07%
Totals		\$854,748.95			100.00 %

## Notes:

(1) According to DLLR officials, these charges are shared by three DOL programs (Labor Market Analysis, Job Service, and UI). However, they were unable to tell us how much was charged to each of the three programs.

(2) DLLR officials were unable to identify the funding source for these costs. Our review indicates that these costs are probably being funded through the U.S. Department of Education.

(3) DLLR officials were unable to identify the funding source for these costs. There are indications that it was funded through Job Service, but DLLR officials were unable to confirm this information.

## Total Amount of Rebates Attributable to Individual DOL Programs

Funding Source	Federal Fiscal Year	Total Rebates	DOL Program Office Percentage Share	DOL Program Office Share of Rebate
BLS	FFY 1998	\$165,109	1.07%	\$ 1,767
	FFY 1999	744,130	1.46%	10,864
	FFY 2000	363,544	0.12%	436
BLS Subtotals				\$13,067
ES	FFY 1998	\$165,109	18.66%	\$30,809
	FFY 1999	744,130	20.19%	150,240
	FFY 2000	363,544	21.14%	76,853
ES Subtotals				\$257,902
ETA	FFY 1998	\$165,109	0.09%	\$149
	FFY 1999	744,130	0.13%	967
	FFY 2000	363,544	0.20%	727
ETA Subtotals				\$1,843
UI	FFY 1998	\$165,109	73.88%	\$121,983
	FFY 1999	744,130	68.26%	507,943
	FFY 2000	363,544	71.85%	261,206
UI Subtotals				\$891,132
VETS	FFY 1998	\$165,109	3.22%	\$5,317
	FFY 1999	744,130	5.71%	42,490
	FFY 2000	363,544	2.82%	10,252
VETS Subtotals				\$58,058
Adjustment due to spreadsheet rounding of percentages.				\$18
<b>Total DOL Share of Rebates</b>				<b>\$1,222,020</b>

**Total Amount of Unallowable Interest Costs Charged  
to Individual DOL Programs**

<b>Funding Source</b>	<b>Federal Fiscal Year</b>	<b>Total Unallowable Interest Costs</b>	<b>DOL Program Office Percentage Share</b>	<b>Unallowable Interest Costs Charged to Individual DOL Program Offices</b>
BLS	FFY 1997	\$52,063	1.07%	\$557
	FFY 1998	30,291	1.07%	324
	FFY 1999	28,556	1.46%	417
	FFY 2000	10,930	0.12%	13
BLS Subtotals				\$1,311
ES	FFY 1997	\$52,063	18.66%	\$9,715
	FFY 1998	30,291	18.66%	5,652
	FFY 1999	28,556	20.19%	5,765
	FFY 2000	10,930	21.14%	2,311
ES Subtotals				\$23,443
ETA	FFY 1997	\$52,063	0.09%	\$47
	FFY 1998	30,291	0.09%	27
	FFY 1999	28,556	0.13%	37
	FFY 2000	10,930	0.20%	22
ETA Subtotals				\$133
UI	FFY 1997	\$52,063	73.88%	\$38,464
	FFY 1998	30,291	73.88%	22,379
	FFY 1999	28,556	68.26%	19,492
	FFY 2000	10,930	71.85%	7,853
UI Subtotals				\$88,189
VETS	FFY 1997	\$52,063	3.22%	\$1,676
	FFY 1998	30,291	3.22%	975
	FFY 1999	28,556	5.71%	1,631
	FFY 2000	10,930	2.82%	308
VETS Subtotals				\$4,591
Adjustment due to spreadsheet rounding of percentages.				\$8
<b>Total Unallowable Interest Costs Charged to DOL</b>				<b>\$117,675</b>



**AUDITEE'S RESPONSE**