

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210



JUN 21 2004

MEMORANDUM FOR: EMILY STOVER DeROCCO
Assistant Secretary
for Employment and Training

FROM: *Elliot P. Lewis*
ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: Audit of New Jersey Department of Labor's
ADP/IT Central Services Costs Charges to U.S. DOL Grants
During the Period July 1, 1996 through June 30, 1999
Final Audit Report 03-04-003-03-315

The attached subject final report is submitted for your resolution action. We request a response to this report within 60 days.

It is your office's responsibility to transmit the attached report promptly to the program officials for resolution. However, we are providing a courtesy copy directly to New Jersey Department of Labor.

If you have any questions about this report, please contact Michael T. Hill, Regional Inspector General for Audit, in Philadelphia at (215) 446-3710.

Attachment

cc: Laura Patton Watson, Grant/Contracting Officer, Division of Resolution and Appeals
Closeout Unit
Victor M. Lopez, Chief, Division of Cost Determination
Cheryl Atkinson, Administrator, Office of Workforce Security

STATE OF NEW JERSEY

AUDIT OF ADP/IT CENTRAL SERVICES COSTS

CHARGED TO

U.S. DOL GRANTS ADMINISTERED BY

NEW JERSEY DEPARTMENT OF LABOR

FROM JULY 1, 1996, THROUGH JUNE 30, 1999

FINAL REPORT

This audit was performed by Tichenor & Associates, LLP, 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.

Elisat P. Lewis

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

Final Audit Report No: 03-04-003-03-315

Date Issued: June 21, 2004

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ACRONYMS

ADP/IT	Automatic Data Processing/Information Technology
BLS	U.S. Department of Labor, Bureau of Labor Statistics
CSCAP	Central Services Cost Allocation Plan
DIT	State of New Jersey Department of Labor, Division of Information Technology
ES	U.S. Department of Labor, Employment Service
ETA	U.S. Department of Labor, Employment and Training Administration
HHS	U.S. Department of Health and Human Services
NJDOL	State of New Jersey, Department of Labor
NJOMB	New Jersey Office of Management and Budget
OIG	U.S. Department of Labor, Office of Inspector General
NJOIT	New Jersey Office of Information Technology
OMB	U.S. Office of Management and Budget
SFY	State Fiscal Year (July 1 through June 30)
SWCAP	State-Wide Cost Allocation Plan
UI	Unemployment Insurance
USDOL	U.S. Department of Labor
VETS	Veterans' Employment and Training Service

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INDEPENDENT ACCOUNTANT'S REPORT ON AUDIT

Tichenor & Associates, LLP, under contract to the U.S. Department of Labor (USDOL), Office of Inspector General (OIG), performed an audit of the central services automatic data processing and information technology (ADP/IT) costs charged to USDOL grants awarded to the State of New Jersey's Department of Labor (NJDOL) for State Fiscal Years (SFYs) 1997, 1998, and 1999.

The initial objective of this audit was to determine whether the ADP/IT central services costs charged to USDOL Unemployment Insurance (UI) grants awarded to NJDOL for SFY 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 NJDOL. However, at the request of the USDOL/OIG, we subsequently expanded the scope of our audit to include all USDOL grant awards (except Job Corps) to NJDOL for SFYs 1997, 1998, and 1999. Final costs were not available for SFY 2000; therefore, we did not include SFY 2000 within our audit scope.

Based on the results of our audit, we questioned a total of \$475,149 in ADP/IT central services costs charged to USDOL grant awards by NJDOL during SFYs 1997, 1998, and 1999 that did not comply with Federal costs principles mandated by OMB Circular A-87. Specifically, we found that NJDOL had been notified that ADP/IT central services cost had net overbillings totaling \$994,138 during SFYs 1997, 1998, and 1999, of which \$475,149 were applicable to USDOL grant awards.

Additionally, we found that the New Jersey Office of Information Technology's (NJOIT) HUB Building interest and depreciation costs billed to NJDOL were miscalculated for the 3 SFYs in our audit period. In reviewing the Auditee's response, we agree that the HUB Building reported interest cost was understated by \$285,692. We found that reported depreciation cost was

overstated by \$334,698. The understatement of interest costs and the overstatement of depreciation costs resulted in a net over recovery of \$49,006. Of this amount, NJOIT overbilled NJDOL for building interest and depreciation costs for a net amount of \$6,359, of which \$4,712 was charged to USDOL grants.

Finally, a variance analysis we performed of NJOIT's billing rates disclosed significant increases (ranging from 24 to 194 percent) in NJOIT's SFY 2000 rates over its SFY 1999 rates. These increases were apparently caused by a decrease in the utilization of NJOIT's ADP/IT central services by a number of State agencies whose programs were being moved from NJOIT's central services "Enterprise Server" (mainframe) computing environment to a new "client server" computing environment. NJOIT officials acknowledged that certain programs that rely on mainframe processing, such as UI, will be required to fund even more of the mainframe operating costs as other programs migrate to the new "client server" environment.

They also acknowledged that certain users, including NJDOL, expressed concern about the escalating costs of NJOIT's services. NJDOL officials stated that they are "locked" into the NJOIT mainframe system and cannot move to an individual "client server" environment without major technological adjustments and capital investments. However, at the time of our field work, the State of New Jersey had not established a strategic technology plan for equitably migrating existing State and Federal programs serviced by the "Enterprise Server" (mainframe) to the new environment. As a result, Federal programs that rely on the mainframe processing, such as the USDOL-funded UI program, will be funding an increasing share of the mainframe operational costs as State programs migrate from the mainframe to the new platform. We originally recommended in our draft report that the State conduct a feasibility study to determine the most efficient, effective, and economical computing platform for meeting the ADP/IT needs of USDOL grant programs to ensure that ADP/IT central services are reasonable. The State subsequently completed that feasibility study, and our recommendations have been revised accordingly.

This 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 Comptroller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of NJDOL'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 USDOL; however, the final report is a matter of public record and its distribution is not limited.



TICHENOR & ASSOCIATES, LLP
Louisville, Kentucky
April 29, 2004

EXECUTIVE SUMMARY

Tichenor & Associates, LLP, under contract to the U.S. Department of Labor (USDOL), Office of Inspector General (OIG), performed an audit of the central services automatic data processing and information technology (ADP/IT) costs charged to USDOL grants awarded to New Jersey's Department of Labor (NJDOL) for State Fiscal Years (SFYs) 1997, 1998, and 1999.

The initial audit objective was to determine whether the ADP/IT central services costs charged to USDOL Unemployment Insurance (UI) grants awarded to NJDOL for SFY 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 NJDOL. However, at the request of the USDOL/OIG, we subsequently expanded the scope to include all USDOL grant awards (except Job Corps) to NJDOL for SFYs 1997, 1998, and 1999.

To achieve our objectives, we interviewed New Jersey Office of Information Technology (NJOIT) and NJDOL officials, as well as reviewed New Jersey's State-Wide Cost Allocation Plan (SWCAP) for SFYs 1997 through 1999. We performed analytical procedures to determine if ADP/IT costs were reasonable and allowable. We did not perform detailed testing of cost transactions. To determine if the costs were allocated based on final cost objectives, we reviewed the central services cost allocation plan (CSCAP) methodology for allocating the ADP/IT costs to departmental and product line cost centers.

Additionally, we performed an analysis of NJOIT's billing rates and usage statistics to determine if Federal programs (such as the USDOL-funded UI program) that rely on the mainframe processing are funding an unreasonably increasing share of the mainframe operational costs as State programs migrate from the mainframe to the new "client server" platform. We compared the billing rates between SFY 1999 and 2000 to determine if rates increased significantly. We also compared NJOIT's usage statistics for SFYs 1997 through 2000 to determine if the utilization of NJOIT's various ADP/IT central services by the various State agencies decreased significantly.

AUDIT RESULTS

We question a total of \$475,149 in ADP/IT central services costs charged to USDOL grant awards by NJDOL because it did not comply with Federal cost principles. The total amount questioned includes \$475,149 in overcharges that were based on budget estimates but were not adjusted to actual cost when this data became available. Specifically, we found that NJDOL had been overcharged for ADP/IT central services provided by NJOIT. These overcharges represented the difference of the total amount NJOIT billed NJDOL and the actual costs NJOIT incurred for the same period. The overcharges occurred because, although NJOIT subsequently calculated its actual costs for these services and provided this information to NJDOL, NJOIT failed to refund these net overcharges to NJDOL, as required by OMB Circular A-87. In

addition, NJOIT failed to prepare and include in its CSCAPs a schedule comparing its total revenues (based on budget estimates) to its actual allowable cost and to address how it would handle any resulting variances. As a result of NJOIT not providing refunds to the NJDOL, USDOL grant awards were overcharged \$475,149 for SFYs 1997 through 1999. (Finding No. 1)

Additionally, we found that NJOIT's HUB Building interest and depreciation costs billed to NJDOL were miscalculated for the 3 SFYs in our audit period. By reviewing the Auditee's response we agree that the HUB Building reported interest cost was understated by \$285,692. We found that reported depreciation cost was overstated by \$334,698. The understatement of interest cost and the overstatement of depreciation costs resulted in a net over-recovery of \$49,006. Of this amount, NJOIT overbilled NJDOL for building interest and depreciation costs for a net amount of \$6,359, of which \$4,712 was charged to USDOL grants. (Finding No. 2)

Finally, NJOIT's SFY 2000 billing rates increased significantly compared to its SFY 1999 billing rates. The increases were primarily caused by a decrease in the utilization of NJOIT's ADP/IT central services by a number of State agencies whose programs were being moved from NJOIT's central services "Enterprise Server" (mainframe) computing environment to a new "client server" computing environment. However, at the time of our audit, the State of New Jersey had not established a strategic technology plan for equitably migrating existing State and Federal programs serviced by the "Enterprise Server" (mainframe) to the new environment. As a result, Federal programs (such as the USDOL-funded UI program) that rely on the mainframe processing will be funding an increasing share of the mainframe operational costs as State programs migrate from the mainframe to the new platform. We believe that the State should conduct a feasibility study to determine the most efficient, effective, and economical computing platform for meeting the ADP/IT needs of USDOL grant programs to ensure that ADP/IT central services are reasonable. (Finding No. 3)

AUDITEE'S RESPONSE AND AUDITOR'S CONCLUSION

In its response to our draft report, NJDOL agreed with our audit that USDOL grants were overcharged \$475,149 for SFYs 1997 through 1999. However, the response stated that NJDOL had reviewed NJOIT's ADP/IT central services charges for SFY's 2000 through 2003 and determined that USDOL grants were undercharged a total of \$858,481 during this subsequent period. According to NJDOL, this resulted in a net undercharge for Fiscal Years 1997 to 2003 of \$383,332. However, we have not audited the reasonableness and allowability of the costs that were purportedly undercharged to USDOL grants during SFYs 2000 through 2003. NJDOL officials stated they would work with NJOIT to obtain even more accurate billings and reflect only appropriate charges in the USDOL grants. Any future overcharges will be offset or credited to the Federal programs. ETA's Grant Officer will resolve the recommendations related to this finding. (Finding No. 1)

NJDOL recalculated HUB Building interest costs, based on the Certificates of Participation on the HUB Building Lease-Purchase Agreement, and determined that Federal grants for SFYs

1997, 1998, and 1999, were understated by \$285,692. We had determined that depreciation expenses were overstated by \$334,698. In its response, NJDOL stated that because of these over- and understatements it calculated \$6,359 of unallowable HUB Building interest and depreciation costs were charged to NJDOL during the 3-year period covered by the audit. Of this amount, \$4,712 had been charged/allocated to USDOL programs. We agree with NJDOL's conclusion. ETA's Grant Officer will resolve the recommendation related to this finding. (Finding No. 2).

Concerning our draft report recommendation to conduct a feasibility study of the computing platform used to meet the ADP/IT needs of USDOL grant programs, the NJDOL response stated that a feasibility study was completed in 2003, and it is now proceeding with a comprehensive unemployment insurance modernization project to move the UI benefits program to a "client server" environment. ETA's Grant Officer will resolve the recommendations related to this finding. (Finding No. 3)

A copy of NJDOL's complete response to the draft report is included in this report as an Exhibit.

RECOMMENDATIONS

We recommend USDOL, Employment and Training Administration (ETA) officials, and USDOL Grant Officers take the following action:

1. We recommend the USDOL Assistant Secretary for Employment and Training ensure:
 - a. The cognizant USDOL Grant Officers make the necessary adjustments to the applicable USDOL grant awards for net ADP/IT central services overcharges totaling \$475,149 in SFYs 1997, 1998, and 1999.
 - b. The cognizant USDOL Grant Officers review the reasonableness and allowability of the \$858,481 in undercharges for ADP/IT cost alleged to have occurred in SFYs 2000, 2001, 2002, and 2003.
2. We recommend the USDOL Assistant Secretary for Employment and Training direct NJDOL to implement internal control policies and procedures to ensure that costs claimed on USDOL grant awards are "net of all applicable credits," as required by OMB Circular A-87.
3. We recommend the USDOL Assistant Secretary for Employment and Training direct NJDOL to institute controls to annually monitor the interest and depreciation costs included in the NJOIT central services costs and to ensure these costs are accurately charged to USDOL grant awards.
4. We recommend the USDOL Assistant Secretary for Employment and Training evaluate both the State's feasibility study and strategic master deployment plan for a 5-year initiative to modernize UI benefit operations through an across-the-board updating and integration of information systems, to ensure that the ADP/IT costs charged to USDOL grants will be reasonable and necessary.

5. We recommend the USDOL Assistant Secretary for Employment and Training closely monitor the utilization and costs of the ADP/IT services during this 5-year conversion process to ensure that USDOL grant awards are not absorbing any excess costs attributable to decisions made by the State.

INTRODUCTION

BACKGROUND

In recent years, the USDOL/ETA has expressed concern that state UI programs that obtained ADP/IT services from outside the UI agency tended to have much higher ADP/IT costs than state UI programs that had their own in-house ADP/IT capabilities. Accordingly, ETA requested that USDOL/OIG consider this matter in planning its future audit work.

NJDOL receives substantial Federal funding annually from ETA, including funding for the State UI program. NJDOL procures its computer mainframe ADP/IT services from NJOIT, which is a central services bureau that provides ADP/IT central services (including computer mainframe services) to 19 agencies and departments within the executive and legislative branches of the New Jersey State government. Although NJOIT does not receive a State appropriation to cover its operational costs, its budget is included as part of the State's annual budget. NJOIT is required to recover 100 percent of its operational costs from its customers for computer usage/services rendered, but NJOIT is not allowed to over-recover its costs. During SFYs 1997 through 1999, NJOIT's ADP/IT central services billings totaled almost \$250 million, of which about \$34 million was billed to USDOL grant programs administered by NJDOL.

NJOIT uses a charge-back system under which it submits monthly invoices to NJDOL based on NJOIT's "State full cost rate" and/or its "Federal claiming rate." The "State full cost rate" invoices are generated to recover 100 percent of NJOIT's budgeted operating costs by applying actual resource utilization to budgeted rates, except for the month of June, the last month of the SFY. The June bills are based on the remaining, unrecovered, annual budgeted costs without regard for the actual utilization that month. Instead, each user organization is billed for its share of the remaining, unrecovered, annual budgeted costs based on each user's percentage of utilization in the preceding 11 months.

The "Federal claiming rate" invoices are submitted to NJDOL monthly and are generally less than the "State full cost rate" invoices. These Federal invoices are based on the "State full cost rate," which is modified to: (1) add certain allowable costs that are incurred by the State but not included in NJOIT's budgeted operating costs (e.g., fringe benefit costs applicable to State salaries), and (2) delete any costs that are unallowable under Federal cost principles set forth in OMB Circular A-87 (e.g., capital expenditures). After each year-end closing, NJOIT provides NJDOL with a "Revised Federal Claiming Document" transmittal containing actual annual costs based on rates developed using actual costs and actual utilization.

OBJECTIVES, SCOPE AND METHODOLOGY

The initial objective of this audit was to determine whether the ADP/IT central services costs charged to USDOL UI grants awarded to NJDOL for SFY 1999 were reasonable, allowable, and allocable under the Federal cost principles set forth in OMB Circular A-87, and the terms and conditions of the UI grant awarded to NJDOL. However, at the request of the USDOL/OIG, we subsequently expanded the scope to include all USDOL grant awards (except Job Corps) to NJDOL for SFYs 1997, 1998, and 1999. The scope of our audit did not include SFY 2000 because final actual cost data were not available to determine if the costs were allowable and allocable for this period. However, we used SFY 2000 budgeted rates and actual utilization to determine if Federal programs are funding a reasonable share of the mainframe operation.

To achieve our audit objectives, we interviewed NJOIT and NJDOL officials and reviewed New Jersey's SWCAP for SFYs 1997 through 1999. We interviewed NJOIT and NJDOL officials to determine the methodology used for allocating and charging NJOIT monthly billings to various benefiting cost objectives as required by OMB Circular A-87. We reviewed ADP/IT costs charged to Federal programs to determine if they were reasonable, allowable, and allocable to DOL programs based on final cost objectives.

To determine if the ADP/IT costs were reasonable, we compared all budgeted rates between SFYs 1999 and 2000, and all usage categories for SFYs 1997 through 2000. To determine if the ADP/IT costs were allowable, we obtained a list of all NJOIT departmental cost categories. We then reviewed the list to determine if the costs contained within these categories were allowable in accordance with costs listed in OMB Circular A-87, Attachment B. We did not perform detailed testing of cost transactions. In addition, we interviewed NJOIT officials to determine if they completed a required schedule comparing total revenues generated by each ADP/IT central service to the allowable costs of the services for our audit period, and if they made adjustments to DOL grants for any variances. Also, we reviewed the NJOIT Cost Development Rate Determination and Billing Methodology to determine procedures for year-end adjustment to Federal programs.

To determine if the costs were allocated based on final cost objectives, we reviewed the CSCAP methodology for allocating the ADP/IT costs to departmental and product line cost centers. We selected two Federal programs and one State program to determine if NJOIT consistently applied the ADP/IT rates to both Federal and State programs. To test Federal and State program ADP/IT cost, we judgmentally selected two USDOL UI programs based on their high volume of computer transactions completed for April 1999, and we haphazardly selected one State program, the Vocational Rehabilitation Service for April 1999.

To determine if allowable interest and depreciation was included in NJOIT's CSCAP, we interviewed NJOIT and New Jersey Office of Management and Budget (NJOMB) officials. Although NJOIT and NJOMB officials were initially unable to provide adequate documentation to support the building interest and depreciation costs charged to NJDOL, we obtained the Budget Certificates of Participation New Issue for the HUB Building lease-purchase agreement to determine the allowable interest expense. The IBM mainframe used by NJDOL Federal and State programs is housed in the HUB building. The Certificates of Participation were issued as

part of a lease-purchase agreement between the State of New Jersey and a private corporation to provide funds necessary to finance the construction of the HUB building. NJOMB officials provided a fixed asset schedule that we used to determine the total allowable HUB Building depreciation for our 3-year audit period.

Finally, we performed an analysis of NJOIT's billing rates and usage statistics to determine if Federal programs (such as the USDOL-funded UI program) that rely on the mainframe processing are funding an unreasonably increasing share of the mainframe operational costs as State programs migrate from the mainframe to the new "client server" platform. We compared the billing rates between SFYs 1999 and 2000 to determine if rates increased significantly. We also compared NJOIT's usage statistics for SFYs 1997 through 2000 to determine if the utilization of NJOIT's various ADP/IT central services by the various State agencies decreased significantly.

Our audit was performed in accordance with applicable standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards* issued by the Comptroller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of NJDOL'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 NJOIT offices and NJDOL offices in Trenton, New Jersey.

FINDINGS AND RECOMMENDATIONS

Finding 1. ADP/IT Central Services Overcharges Totaling \$475,149 Were Not Credited to USDOL Grant Awards as Required by Federal Cost Principles

Our audit found that NJDOL had been overcharged for ADP/IT central services provided by the New Jersey Office of Technology (NJOIT). These overcharges represent the difference between the total amount NJOIT billed NJDOL and NJOIT's actual incurred costs for these services. The overcharges occurred because, although NJOIT subsequently calculated its actual costs for these services and provided this information to NJDOL, NJOIT failed to refund these net overcharges to NJDOL as required by OMB Circular A-87. In addition, NJOIT failed to prepare and include in its CSCAPs a schedule comparing its total revenues (based on budget estimates) to its actual allowable costs and to address how it would handle any resulting variances. As a result of NJOIT not providing refunds, the NJDOL was overcharged \$994,138 for ADP/IT central services during SFYs 1997 through 1999, of which \$475,149 (or 48 percent) were charged to USDOL grant awards.

Federal Cost Principles

Federal cost principles state that, to be allowable under Federal awards, costs must be "the net of all applicable credits." The phrase "applicable credits" refers to those receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards, including rebates and adjustments for overpayments.

Regarding credits involving central services costs charged to Federal grant awards, OMB Circular A-87, Attachment C, paragraph E.3.b(1), requires that the CSCAPs submitted by internal service funds include, among other things, a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service, with an explanation of how variances would be handled. These adjustments must be made annually and by one of the following methods:

- (1) a cash refund to the Federal Government for the Federal share of the adjustment;
- (2) credits to the amounts charged to the individual programs;
- (3) adjustments to future billing rates; or
- (4) adjustments to allocated central services costs (except that adjustments to allocated central services will not be permitted where the total Federal and non-Federal share of the adjustment exceeds \$500,000).

NJOIT's Central Services Billing Methodology

Our fieldwork disclosed that the CSCAPs NJOIT uses to establish billing rates for the various central services it provides to State agencies are basically designed to recover NJOIT's budgeted

costs for the year. These CSCAPs are approved by the NJOMB. NJOIT uses a charge-back system under which it submits monthly invoices to NJDOL based on NJOIT's "State full cost rate" and/or its "Federal claiming rate." The ADP/IT central services costs billed to NJDOL using the "Federal claiming rate" are then charged by NJDOL to its various administrative functions and USDOL grant awards based on actual utilization.

Our analysis of NJOIT's CSCAPs revealed that they did not include a schedule comparing total revenues generated by the service to the allowable costs of the services, with an explanation of how the variances would be handled during the 3-year period covered by our audit. We also found that NJOIT failed to make the required adjustments for differences between its revenue and allowable costs by refunding/crediting the overcharges to NJDOL, so it, in turn, could refund/credit these amounts to the Federal Government as required by OMB Circular A-87.

When we asked NJDOL officials about the methodology they used to allocate NJOIT rebates for these overcharges to its various cost objectives (including Federal grant awards), they stated that NJDOL had not received any rebates or credits from NJOIT for these overcharges. Instead, NJOIT simply provides them with a final "Federal claiming rate" document each year with instructions that the enclosed "Revised Federal Claiming Document" was provided to support any retroactive claiming adjustment that the client would submit to the Federal Government.

NJOIT officials stated that they were only responsible for calculating and providing actual costs at year-end to its user agencies, including NJDOL, and that NJOIT had done this through the issuance of a final "Revised Federal Claiming Document" based on its actual costs and actual utilization data. They further stated that it was each user agency's responsibility to perform the "billed to actual comparison" and to make any retroactive adjustment with the applicable Federal agencies. Our review of the NJOIT Cost Development Rate Determination and Billing Methodology confirmed that it states, "It is each agency's responsibility based on year-end rates, to adjust charges to Federal programs accordingly." However, an NJOIT official concurred with OIG's understanding that, to comply with OMB Circular A-87, NJOIT should compare its total revenues (based on budget estimates) to its actual allowable costs and address how it would handle any resulting variances.

As a result, NJOIT should revise NJOIT Cost Development Rate Determination and Billing Methodology policies and procedures to conform to Federal OMB Circular A-87 cost principles. The procedures should include NJOIT preparing an annual schedule comparing total revenues generated by the service to the allowable costs of the service, with an explanation of how variances would be handled.

Computation of Overcharges by Auditors

Our comparison of the amounts in the "Revised Federal Claiming Document" to the amounts in the original "Federal claiming rate" invoices for the audit period SFYs 1997 through 1999 showed that NJDOL had been overcharged a total of \$994,138 for ADP/IT central services, of which \$562,886 had been charged to USDOL UI grant awards. We also found that other USDOL grant awards had net undercharges totaling (\$87,737.) Thus, the total net ADP/IT overcharges to USDOL grant awards totaled \$475,149.

NJDOL also performed a reconciliation of the budgeted costs billed to NJDOL to the actual costs included in the final Federal claiming documents, and it was aware of the overcharges. However, as previously discussed, NJDOL did not refund/credit the overcharges to the USDOL grant awards because it never received any refunds/credits from NJOIT.

Auditee’s Response and Auditor’s Conclusion

NJDOL agreed that for the period involving State Fiscal Years (SFY) 1997 through SFY 1999 there was a net overcharge to USDOL grants of \$475,149. However, the response stated that NJDOL reviewed grant charges for SFYs 2000 through 2003 and determined that USDOL grants were undercharged a total of \$858,481 during this subsequent period. According to NJDOL this resulted in a net undercharge for SFYs 1997 to 2003 of \$383,332. The response also stated NJDOL would work with NJOIT to obtain even more accurate billings and reflect only appropriate charges in the USDOL grants, and that any future overcharges would be offset or credited to the Federal programs.

In short, NJDOL has agreed with the Auditor’s finding for SFYs 1997 through 1999. However, we have not audited the accuracy and validity of NJDOL’s review of NJOIT’s ADP/IT central services charges for SFY’s 2000 through 2003, nor the reasonableness and allowability of the costs that were purportedly undercharged to USDOL grants during this period. ETA’s Grant Officer will resolve the recommendations related to this finding.

Recommendations

1. We recommend the USDOL Assistant Secretary for Employment and Training ensure that:
 - a. The cognizant USDOL Grant Officers direct NJDOL to make the necessary adjustments to the applicable USDOL grant awards for net ADP/IT central services overcharges totaling \$475,149 in SFYs 1997, 1998, and 1999, as follows:

Bureau of Labor Statistics (BLS)	\$ (759)
Employment Service	(91,017)
Veterans’ Employment and Training Service (VETS)	4,050
Unemployment Insurance	562,886
OSHA	(11)
Total	\$ 475,149

[Note: For audit resolution purposes, we will not track adjustments for grant awards with net overcharges that are equal to or less than \$5,000.]

- b. The cognizant USDOL Grant Officers review the reasonableness and allowability of the \$858,481 in undercharges for ADP/IT costs alleged to have occurred in SFYs 2000, 2001, 2002, and 2003.

2. We recommend that the USDOL Assistant Secretary for Employment and Training direct NJDOL to implement internal control policies and procedures to ensure that all future costs claimed on USDOL grant awards are “net of all applicable credits,” as required by the Federal cost principles mandated by OMB Circular A-87.

Finding 2. Deficiencies in the Calculations of Interest and Depreciation Costs for the HUB Building

Our audit disclosed that NJOIT’s HUB Building interest and depreciation costs billed to NJDOL were miscalculated. The miscalculation occurred because NJOIT did not maintain documentation to support the calculations of the amount of interest and depreciation costs reported in the CSCAPs. As specified in OMB Circular A-87, to be allowable, costs must be adequately documented and may not exceed actual incurred costs.

In response to the draft report, NJDOL provided schedules to demonstrate how the HUB Building interest cost should be calculated based on the Certificates of Participation on the HUB Building Lease-Purchase Agreement. Their calculations show, for the period audited, that NJDOL undercharged interest on Federal grants. We found that depreciation expense for the HUB building was overstated. We agree with the NJDOL’s conclusions.

NJOIT’s enterprise server (mainframe) and related peripherals are housed in a location called the HUB Building. NJOIT included HUB Building acquisition interest expense and building depreciation as part of the costs to be recovered in its CSCAPs. In response to the draft report, NJDOL recalculated the amount of HUB Building interest cost, using documentation such as interest costs identified in the State of New Jersey Budget regarding the Certificates of Participation New Issue for the HUB Building Lease-Purchase Agreement and the coupon interest amount for each payment period. NJDOL recalculated the allowable interest expense actually incurred for SFYs 1997, 1998, and 1999, and determined that the interest expense in the CSCAPS was understated by \$285,692. The Auditor agrees with this calculation.

To determine the amount of HUB Building depreciation expense, we used a fixed asset schedule provided by NJOMB. The fixed asset schedule showed \$10,185,291 in building costs to be depreciated. However, once the amount was divided by the 40-year useful life that NJOIT said it uses to depreciate its buildings (based on the straight-line depreciation method), we arrived at a much lower annual depreciation rate of (\$254,632), which is less than the (\$366,198) used in NJOIT’s CSCAPs for the 3-year audit period.

Description	SFY 1997	SFY 1998	SFY 1999	Totals
Under-Recovery of Interest Costs	(\$139,066)	(\$95,713)	(\$50,913)	(\$285,692)
Over-Recovery of Depreciation Expense	\$111,566	\$111,566	\$111,566	\$334,698
Total Net (Under)/Over Recovery of HUB Building Expenses	(\$27,500)	\$15,853	\$60,653	\$49,006
NJDOL’s Share of Total NJOIT billings	13.99%	13.80%	13.22%	
Total Over Billings of HUB Building Expenses to NJDOL	(\$3,847)	\$2,188	\$8,018	\$6,359

As shown above, the net amount of HUB Building expenses overbilled to NJDOL during the 3-year period covered by our audit was \$6,359. NJDOL calculated that \$4,712 of this amount had been charged/allocated to USDOL programs (e.g., BLS, ES, ETA, UI, and VETS). We determined the amount of unallowable interest and depreciation costs charged to each USDOL

program by calculating the percentage of NJOIT costs charged to each program to the total NJOIT billings to NJDOL. We consider the amount overcharged to the USDOL programs immaterial, and we do not recommend that the questioned costs be refunded to USDOL. However, NJOIT needs to ensure that HUB interest and depreciation costs are documented, accurately calculated, and correctly reported in its CSCAP.

Auditee's Response and Auditor's Conclusion

NJDOL found that NJOIT's approved CSCAPs included building interest and depreciation costs were inaccurate for the three SFYs in our audit period. However, using documentation obtained during the audit by DOL/OIG, it was able to determine that the HUB Building Expenses reported interest cost was understated by \$285,692. When adding this amount to the overstated reported depreciation cost of \$334,698, NJDOL calculated a net over-recovery of \$49,006. As a result, NJOIT overbilled NJDOL for building interest and depreciation costs for a net amount of \$6,359, of which \$4,712 was charged to USDOL grants. We reviewed documentation that was used to calculate the interest costs and concur with NJDOL. As a result, we revised the finding to reflect the correct amount of interest costs. We compared the undercharged interest costs to the overcharged depreciation costs and agree there was a net overcharge to USDOL grants of \$4,712. The ETA Grant Officer will resolve this recommendation related to this finding.

Recommendation

3. We recommend that the USDOL Assistant Secretary for Employment and Training direct NJDOL to institute controls to annually monitor the interest and depreciation costs included in the NJOIT central services costs and to ensure these costs are accurately charged to USDOL grant awards.

Finding 3. USDOL Needs to Monitor the Utilization and Costs of ADP/IT Central Services Charged to Grants Awarded to NJDOL

NJOIT's SFY 2000 billing rates increased significantly compared to its SFY 1999 billing rates. The increases were primarily caused by a decrease in the use of NJOIT's ADP/IT central services by a number of State agencies whose programs were being moved from NJOIT's central services "Enterprise Server" (mainframe) computing environment to a new "client server" computing environment. At the time of our audit, the State of New Jersey had not established a strategic technology plan for equitably migrating existing State and Federal programs serviced by the "Enterprise Server" (mainframe) to the new environment. As a result, Federal programs (such as the USDOL-funded UI program) that rely on the mainframe processing will be funding an increasing share of the mainframe operational costs as State programs migrate from the mainframe to the new platform. We believe that the State should conduct a feasibility study to determine the most efficient, effective, and economical computing platform for meeting the ADP/IT needs of USDOL grant programs to ensure that ADP/IT central services are reasonable.

OMB Circular A-87, Attachment A, General Principles for Determining Allowable Costs, provides basic guidelines for determining the reasonableness of costs. Among other things, it states that a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

NJOIT recovers its costs of providing ADP/IT services to the various State agencies using billing rates based on budgeted costs applied to actual usage. As part of our audit, we performed a variance analysis that disclosed significant increases (ranging from 24 percent to 194 percent) in NJOIT's SFY 2000 service category billing rates compared to its SFY 1999 rates. We also performed an analysis of NJOIT's usage statistics by service category for SFYs 1997 through 2000 that disclosed a significant decrease in the utilization of NJOIT's various ADP/IT central services by the various State agencies. In short, the costs are greater for the remaining users.

In response to our queries regarding these observations, NJOIT officials stated that the State was moving to a "client server" environment, and that new programs were using this platform rather than the central services "Enterprise Server" (mainframe) computing platform provided by NJOIT. Some State agencies were also moving their older programs to the new "client server" computing environment. NJOIT officials acknowledged that programs, such as UI, that rely on mainframe processing will be required to fund more of the mainframe operating costs as other programs migrate to the new "client server" environment. They also acknowledged that users, including NJDOL, had expressed concern about the escalating costs of NJOIT's services.

Accordingly, we met with NJDOL Division of Information Technology (DIT) officials to obtain more information about the respective roles and relationships between NJOIT and NJDOL/DIT. We were informed that NJDOL/DIT was responsible for coordinating and representing NJDOL's ADP/IT interests, including reviewing the NJOIT billings, and addressing any ADP/IT concerns NJDOL had with NJOIT. In addition, NJDOL/DIT's programmers, program analysts, and

managers provide support for NJDOL's in-house systems.

NJDOL/DIT officials told us that, prior to 1986, NJDOL and other State agencies had their own in-house computers and programmers. However, in 1986 the New Jersey Governor's office made a decision to develop a centralized ADP/IT service system. The stated purpose of the centralized system was to provide better services, faster access, and no worries about programming needs, all at lower costs. All State agencies were required by State regulations to utilize the new centralized ADP/IT services.

However, in recent years (1999–2000) the State has begun encouraging all State agencies (including NJDOL) to move from the NJOIT mainframe to the new "client server farm" managed by NJOIT in which each user will have its own in-house "client server/LAN" system. As the various State agencies make the move to the "client server" environment, agencies (such as NJDOL) that continue to use the ADP/IT central services provided by NJOIT are having to absorb an ever increasing share of the large overhead costs of the old mainframe system operated by NJOIT.

NJDOL/DIT officials stated that because many of the larger programs, such as UI, have had to rely on NJOIT's centralized ADP/IT system for the past 14 years, they are dependent on the NJOIT mainframe system. They said that certain systems (e.g., the UI Benefits Payment System) cannot move from the mainframe computer environment to an individual "client server" environment without major technological adjustments and capital investments. Keeping the UI program on the NJOIT mainframe has the disadvantage of being "stuck" with existing technology and a sharply escalating share of ADP/IT pooled overhead costs. NJDOL/DIT officials said that UI officials would like to enhance their telephone claims system by being able to offer UI claimants 24/7 internet access services. They also said this system would save money and create better services to UI customers, but would require NJOIT to make major and costly enhancements to its mainframe system.

In addition, NJDOL/DIT officials said that since the various State agencies are no longer required by regulations to utilize NJOIT ADP/IT central services, NJDOL would like to move all its systems from the NJOIT mainframe to an in-house system. However, at the time of our audit, NJOIT had not established a strategic technology plan for equitably migrating existing State agencies with Federal programs serviced by the mainframe "Enterprise Server" (e.g., NJDOL) to the new "client server" computing platform. Further, NJDOL/UI officials said they did not have a capital budget to purchase the equipment needed to develop the UI portion of the "client server farm."

In summary, USDOL grant programs administered by NJDOL are absorbing an ever-increasing share of NJOIT's overhead costs as other State agency users are moved from NJOIT's mainframe computing platform to the new "client server" environment. NJOIT officials have acknowledged that users of NJOIT's ADP/IT central services expressed concern about the escalating cost of NJOIT's services. We believe that the significant increases in the costs of ADP/IT central services discussed above are unreasonable and should not be borne by Federal grant programs. Instead, these increased costs should be borne by the State of New Jersey because the increases appear to have been caused primarily by State decisions. In a 1986 decision by the New Jersey Governor's office, NJDOL was required to give up its in-house ADP/IT system and utilize the ADP/IT central services provided by NJOIT. In addition, a more recent decision by the State to begin moving new and selected existing programs from NJOIT's central services to a new "client server" environment was not supported by a fair and equitable plan to ensure that USDOL grant programs were not adversely affected by the State's decisions.

Auditee's Response and Auditor's Conclusion

In the draft report, we recommended that NJDOL conduct a feasibility study to determine the most efficient, effective, and economical computing platform for meeting the ADP/IT needs of USDOL grant programs, including the development of a proposed plan of action for meeting this need. In its response, NJDOL stated that a feasibility study was completed in 2003, and that it is now proceeding with a comprehensive unemployment insurance modernization project to move the UI benefits program to a "client server" environment. The response further stated that NJDOL had also developed a strategic master deployment plan for a 5-year initiative to modernize UI benefit operations through an across-the-board updating and integration of information systems. The response further stated that the technical design would be based on "client server" architecture that will provide the best value for NJDOL in terms of leveraging resources and costs and will result in the full migration of all UI benefits systems applications from the mainframe to the "client server" environment. Additionally, the new system would provide NJDOL with the ability to more closely monitor the utilization and costs of services that are charged to USDOL grant funds, thereby helping to ensure that the Federal Government is paying only for the ADP/IT services that are rendered to NJDOL. ETA's Grant Officer will resolve the recommendations related to this finding.

Recommendations

4. We recommend the USDOL Assistant Secretary for Employment and Training evaluate both the State's feasibility study and strategic master deployment plan for a 5-year initiative to modernize UI benefit operations through an across-the-board updating and integration of information systems, to ensure that the ADP/IT costs charged to USDOL grants will be reasonable and necessary.
5. We also recommend the USDOL Assistant Secretary for Employment and Training closely monitor the utilization and costs of the ADP/IT services during this 5-year conversion process to ensure that USDOL grant awards are not absorbing any excess costs attributable to decisions made by the State.

EXHIBIT
AUDITEE'S RESPONSE



State of New Jersey

DEPARTMENT OF LABOR
PO BOX 110
TRENTON, NEW JERSEY 08625-0110

JAMES E. MCGREEVEY
Governor

ALBERT G. KROLL
Commissioner

March 29, 2004

Michael T. Hill, Regional Inspector General for Audit
Office of Inspector General
U.S. Department of Labor
Philadelphia Regional Audit Office
Public Ledger Building, Suite 1072
150 S. Independence Mall West
Philadelphia, Pennsylvania 19106

Dear Mr. Hill:

We have received and reviewed the draft report entitled "Audit of ADP/IT Central Services Costs Charged to U.S. DOL Grants Administered by New Jersey's Department of Labor During July 1, 1996 Through June 30, 1999."

The attachment to this letter contains a detailed response to the three findings included in the report. This includes comments from the New Jersey Office of Information Technology (OIT) which is responsible for determining and billing costs to our department for centralized ADP services.

Our response indicates that the overcharges reported in your audit period have been offset in subsequent years by undercharges to the USDOL grants or adjustments to the schedules contained in your report.

Additionally, subsequent to your audit team's field visit, we have undertaken an extensive project to modernize the Unemployment Insurance System. This should provide you with new and relevant information as to your concerns expressed in Finding No. 3.

We appreciate the opportunity to respond and to assure that the audit process is complete and useful to all involved parties.

Sincerely,



COMMISSIONER

Attachment



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**OFFICE OF INSPECTOR GENERAL
AUDIT REPORT NO. 03-04-003-03-315
NEW JERSEY DEPARTMENT OF LABOR
RESPONSE TO FINDINGS**

Finding No. 1 (Draft Audit Report – Page 9)

ADP/IT Central Services Overcharges Totaling \$475,149 Were Not Credited to USDOL Grant Awards as Required by Federal Cost Principles.

NJDOL Response

We agree that the period involving fiscal years 1997 through 1999 resulted in a net overcharge to USDOL grants of \$475,149. As directed by your audit staff we have reviewed the subsequent years (2000 through 2003) and determined that USDOL grants were undercharged a total of \$858,481. This results in a net undercharge for fiscal years 1997 to 2003 of \$383,332. Given the complexities of the OIT billing process and the total charges involved, this net undercharge would not be considered a significant or material difference. We will, however, work with OIT to obtain even more accurate billings and reflect only appropriate charges in the USDOL grants. Any future overcharges will be offset or credited to the federal programs.

Finding No. 2 (Draft Audit Report – Page 13)

Deficiencies in the Approved CSCAPs Included Unallowable and/or Unsupported Interest and Depreciation Costs.

OIT Response

The New Jersey Office of Information Technology (OIT) has reviewed the finding by Tichenor & Associates, LLP, under contract to the U.S. Department of Labor (USDOL), Office of Inspector General (OIG) on central services automatic data processing and information technology (ADP/IT) costs charged to USDOL grants awarded to the State of New Jersey's Department of Labor (NJDOL) for State fiscal year (SFYs) 1997, 1998, and 1999 and have found the following:

The interest on USDOL's Exhibit E Interest Rate Comparison for Certificates of Participation on the HUB Building Lease-Purchase Agreement is incorrect. Exhibit E under the heading of Amount Per Amortization Schedule has been calculated incorrectly. The interest amount for six months was divided by three hundred and sixty five days and should have been divided by one hundred and eighty two and one half days. This calculation showed the wrong interest chargeable for the HUB building. The revised Exhibit E is based on the New Jersey Comprehensive Annual Financial Report (NJCAFR) that shows the interest payment on a cash basis in line with the Certificates of Participation, as shown below:

	Period			Amount Per		
	Ending	Coupon	Interest	Amortization Schedule	Amount Per CSCAP	Difference
SFY 1997						
	12/15/1996	6.90%	\$186,147.50	\$ 186,147.50		
	6/15/1997	6.95%	\$186,147.50	\$ 186,147.50		
Total				\$ 372,295.00	\$233,229.00	\$ (139,066.00)
SFY 1998						
	12/15/1997	6.95%	\$165,471.25	\$ 165,471.25		
	6/15/1998	7.00%	\$165,471.25	\$ 165,471.25		
Total				\$ 330,942.50	\$235,229.00	\$ (95,713.50)
SFY 1999						
	12/15/1998	7.00%	\$143,071.25	\$ 143,071.25		
	6/15/1999	7.00%	\$143,071.25	\$ 143,071.25		
Total				\$ 286,142.50	\$235,229.00	\$ (50,913.50)
Total Supported Interest Costs - SFYs 1997, 1998, and 1999						\$ (285,693.00)

The unsupported depreciation expense of \$1,098,594 on USDOL's Exhibit H is correct but is replaced by supported depreciation expense of \$763,896. The NJCAFR shows depreciation expense based on the State's Fixed Asset System. The total amount for the HUB Building on the fixed asset schedule is \$10,185,291 divided by 40 years, for a total of \$254,632 annual depreciation. For the three fiscal years audited the total amount is \$763,896.

Our calculation of the amount of allowable and unallowable interest and depreciation costs that OIT can include in CSCAP and bill to NJDOL during SFY's 1997 through 1999 is shown below.

Description	SFY 1997	SFY 1998	SFY 1999	Totals
Net Over/(Under) Recovery of Interest Costs	\$(139,066.00)	\$ (95,713.50)	\$ (50,913.50)	\$ (285,693.00)
Unsupported Depreciation Expense	\$ 366,198.00	\$ 366,198.00	\$ 366,198.00	\$1,098,594.00
Supported Depreciation Expense	\$(254,632.00)	\$(254,632.00)	\$(254,632.00)	\$ (763,896.00)
Total Unallowable HUB Building Expenses	\$ (27,500.00)	\$ 15,852.50	\$ 60,852.50	\$ 49,005.00
NJDOL's Share of Total OIT Billings (Exhibit F)	13.99%	13.80%	13.22%	
Total Unallowable Costs Charged to NJDOL	\$ (3,847.25)	\$ 2,187.65	\$ 8,018.26	\$ 6,358.66
Bureau of Labor Statistics (BLS)				\$ 91
Employment Service				\$ 703
Veterans Employment and Training Service (VETS)				\$ 5
Unemployment Insurance				\$ 3,914
OSHA				\$ 0
Total				\$ 4,712

After we determined that \$6,359 of unallowable HUB Building interest and depreciation costs charged to NJDOL during the three-year period covered by the audit, we calculated that \$4,712 of this amount had been charged/allocated to USDOL programs (e.g., BLS, ES, UI, and VETS). The amount of unallowable interest and depreciation costs charged to each USDOL program was based on the percentage of OIT costs charged to each program to the total OIT billings to NJDOL on USDOL's Exhibits G and H.

Finding No. 3 (Draft Audit Report – Page 16)

USDOL Needs to Monitor the Utilization and Costs of ADP/IT Central Services Charged to Grants Awarded to NJDOL.

NJDOL Response

As outlined in Finding 3 of the report, NJDOL was subject to increased OIT billing rates in SFY 2000 due to decreased usage of OIT's ADP/IT central services by a number of State agencies whose programs were moved from OIT's central services "Enterprise Service" (mainframe) computing environment to new "client server" computing environments.

NJDOL concurs with Finding 3, recommending that the State conduct a feasibility study to determine the most efficient, effective, and economical computing platform for meeting the