DATE: September 30, 2004

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

Elliot P. Lewis

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: State Workforce Agencies' Workforce Investment Act Grant Programs Are Accruing Federal Equity in Real Properties
Management Letter No. 06-04-003-03-325

SUMMARY

Some State Workforce Agencies (SWA) are amortizing the acquisition costs of real property against Workforce Investment Act (WIA) grant funds, although 20 CFR §667.260 specifically prohibits the use of WIA grant funds for the "construction or purchase of facilities or buildings." The only allowable premises costs WIA grantees can charge for grantee-owned properties are depreciation (or a two percent use charge), interest, and operations and maintenance (O&M) costs.[1] While the Employment and Training Administration (ETA) has been aware of this issue for some time, ETA has not provided guidance to the states.

Therefore, WIA grant programs are accruing "equity" in states' real property, contrary to Federal regulations; i.e., these grant programs are incurring unallowable costs to the extent that their amortized share of acquisition costs (land, buildings, and interest) exceeds their share of building depreciation -- based on actual useful building life -- and interest costs (on building only).

BACKGROUND

In 2001, the Office of Inspector General (OIG) conducted a review of shared facility arrangements between one SWA and several WIA local workforce

[1] O&M costs are allowable premises costs whether grantees are amortizing acquisition costs or charging depreciation and interest. Therefore, this management letter, except where quoting the ETA, will not refer to O&M costs.

investment boards (LWIB) within the same state. On September 28, 2001, we issued a management letter[2] that reported One-Stops were paying only O&M costs based on the One-Stop's percentage of total occupancy of the facility, and the unemployment insurance and employment service (UI/ES) programs were amortizing the property's acquisition costs against UI/ES grants. Thus, the One-Stops were occupying space in the facilities rent-free, and the UI/ES programs were paying for space costs not allocable to their programs in violation of WIA, Section 193.

In response to the management letter issues, ETA drafted a Training and Employment Guidance Letter (TEGL) to address real property equity issues and the use of SWA real properties by other grant programs. One of the issues discussed related to the WIA prohibition on "construction or purchase of facilities or buildings." The OIG first reviewed and provided comments to the draft TEGL in December 2002. Additional comments were provided to a revised draft TEGL in November 2003.

While ETA prepared the TEGL to inform the states of SWA real property issues, the TEGL has not yet been issued.

OBJECTIVE, SCOPE, AND METHODOLOGY

The OIG issued a report[3] on September 30, 2004, regarding our assessment of ETA's management controls over Federal equity in SWA real property. It was not an objective of the audit to determine if WIA and other DOL grant funds (e.g., Welfare-to-Work (WtW)) were being used to accrue DOL equity in SWA real property. Therefore, that audit report does not address the issue. However, during that audit, which covered DOL equity in SWA properties as of September 30, 2001, we determined that WIA and WtW funds were being used to accrue DOL equity, as discussed in this management letter.

We limited our examination of this issue to determining: (1) which SWAs included in our judgmental sample of four states (California, Georgia, Texas, and Utah), were still amortizing the acquisition costs of central office properties, and (2) whether the SWAs' amortization schedules charged all programs their pro rata share of such acquisition costs based on the SWA standard allocation methodology. We did not attempt to determine the extent of unallowable costs that have been charged to WIA and WtW grants.

We did not evaluate or test management controls over the SWAs' amortization of acquisition costs or ETA's management controls over the SWA procedures for

[2] Management Letter Report No. 06-01-003-03-325, "Real Property Issues Related to Federal Equity Properties"

[3] Audit report number 06-04-002-03-325, "DOL Has Not Maintained Accountability Over Equity In Real Property Held By States."

that issue; therefore, this report is not intended to provide any assurance over those controls.

We conducted our audit in accordance with Government Auditing Standards for performance audits.

ISSUE

We determined that two of the four SWAs in our audit (Georgia and Utah) were amortizing the acquisition costs of state central office properties against some DOL grant programs (e.g., WIA and WtW) that are not allowed to use grant funds to construct or purchase facilities or buildings.[4] These states were amortizing the acquisition costs (land, buildings, and interest) of real property in lieu of charging the grants for allowable depreciation and interest costs (for buildings only).

Georgia and Utah were amortizing acquisition costs against all grant programs they administer because their amortization schedules/agreements were developed prior to the enactment of the WIA, which specifically prohibits the WIA grantees from accruing equity in SWA real properties. Because these states are amortizing acquisition costs (including land costs) against some grant programs, particularly WIA, over a significantly shorter period of time than a depreciation period (for building only) based on a building's useful life, unallowable costs are being charged to the WIA, and possibly other, grant programs. Furthermore, although the states chosen for this audit were selected using non-scientific sampling methodologies, the fact that two of the four states we audited improperly amortized acquisition costs against all grant programs in violation of regulations would indicated that other states not included in our audit could also be improperly amortizing such costs.

ETA's draft TEGL provides:

> **Action Required.** SWAs must immediately examine their real property procedures, amortization arrangements, and charges to ETA grants for premises costs involving the use of W-P, UI, and Reed Act funds. To the extent these procedures, arrangements, or charges are inconsistent with policies stated in this TEGL, they must be brought into compliance not later than June 30, 2004. States are requested to report any necessary changes to SWA real property data resulting from their examination of their real property procedures, amortization arrangements, and charges not later than December 31, 2003 on the SWA real property report to the ETA Office of Financial and Administrative Services.

[4] The other two states in our audit were no longer amortizing central office space costs because amortization was complete.

However, the draft TEGL has not yet been issued, although the first draft was submitted to the OIG for review in December 2002.

Therefore, some DOL programs are accruing "equity" in states' real property, contrary to Federal regulations; i.e., these grant programs are incurring unallowable costs to the extent that their amortized share of acquisition costs (land, buildings, and interest, if any) exceeds share of building depreciation, based on the building's useful life, and interest costs (on building only).

While ETA did not inform us why the TEGL has not been issued, we believe that ETA has not finalized and issued the draft TEGL because the Administration's proposed WIA reauthorization legislation would transfer DOL's equity in SWA real property to the states and would allow WIA partners to use such property without the current WIA accountability issues (depreciation vs. amortization) when using SWA real property. Under the Administration's proposal, states would be allowed to use such property acquired with UI/ES grants to also administer the WIA program. The Administration's proposed WIA reauthorization legislation provides:

> TRANSFER OF FEDERAL EQUITY-- Notwithstanding any other provision of law, any **Federal equity acquired in real property through grants to States awarded under title III of the Social Security Act or under the Wagner-Peyser Act** is hereby transferred to the States which used the grants for the acquisition of such equity. The portion of any real property that is attributable to the **Federal equity transferred under this section shall be used to carry out activities authorized under title III of the Social Security Act, the Wagner-Peyser Act, or title I of the Workforce Investment Act**. Any disposition of such real property shall be carried out in accordance with the procedures described in section 97.31(c) of title 29 of the Code of Federal Regulations (as in effect the day before the date of enactment of the Workforce Investment Act Amendments of 2003) and the portion of the **proceeds from the disposition of such real property** that is attributable to the Federal equity transferred under this section shall be used to carry out activities authorized **under title III of the Social Security Act or this title**. [Emphasis added.]

To date, the Administration's proposal has not been enacted. Consequently, ETA continues to let the states charge WIA for unallowable space costs.

On November 3, 2003, the Senate incorporated S.1627 in H.R.1261, the "Workforce Investment Act Amendments of 2003," and passed H.R.1261 in lieu of S.1627. As amended by the Senate, H.R.1261 does not provide for WIA

activities to use properties acquired with UI/ES grants. While H.R.1261, as amended, is similar to the Administration's proposal, it contains one significant difference as shown below:

> TRANSFER OF FEDERAL EQUITY. . . The portion of any real property that is attributable to the Federal equity transferred under this section shall be used to carry out activities authorized under **title III of the Social Security Act or the Wagner-Peyser Act** . . . the portion of the proceeds from the disposition of such real property that is attributable to the Federal equity transferred under this section shall be used to carry out activities authorized under **title III of the Social Security Act or the Wagner-Peyser Act**. [Emphasis added.]

Unlike the Administration's proposal, H.R.1261, as amended, does not allow for such property to be used for WIA activities.

RECOMMENDATIONS

We recommend the Assistant Secretary for Employment and Training:

1. Immediately notify all SWAs that they should ensure WIA grants -- and any other DOL grant programs that prohibit the "construction or purchase of facilities or buildings" -- are not accruing DOL equity in SWA real properties.
2. Require the SWAs to self-certify that they are not amortizing acquisition costs to DOL grant programs that do not allow for the accrual of equity.
3. Identify, disallow, and recover any unallowable costs incurred as a result of amortizing real property acquisition costs to those programs.

ETA's RESPONSE

ETA indicated that the primary concern of this management letter focuses on ETA's failure to issue a revised directive on real property issues as agreed to in ETA's response to the OIG 2001 report on real property. ETA indicated that its delay in issuing the guidance was not related to the WIA reauthorization efforts as we stated in our letter report; the soon-to-be released proposed Training Employment and Guidance Letter (TEGL) addresses a wide variety of issues related to real property and is not limited to the issues that were raised in the prior OIG audit.

ETA stated that WIA reauthorization language in the Senate Bill would transfer real property equity to the states and provide that disposition proceeds could be used to administer the states' unemployment insurance and employment service programs. However, since it does not appear that WIA reauthorization will be

enacted in the near future, ETA is pursuing other possible options for addressing the Federal equity issues.

A copy of ETA's complete response to the draft management letter is attached to this final management letter.

AUDITOR'S CONCLUSIONS

ETA's proposed TEGL requires that the states come into compliance with the TEGL's terms by December 31, 2004, and requests the states report any changes to their real property procedures, amortization arrangements, and charges by November 30, 2004. States are also requested to submit proposals for exceptions to existing amortization plans together with certified supporting documentation supporting data on allowable premises costs otherwise payable for these properties. ETA's TEGL, when issued, will sufficiently address recommendations 1 and 2 above. Therefore, recommendations 1 and 2 are resolved and will be closed when the TEGL is issued.

However, the proposed TEGL does not sufficiently address recommendation 3, as it does not specify how ETA will identify, disallow, and recover unallowable amortization costs already charged to WIA/WtW grants in excess of allowable premises costs. Therefore, recommendation 3 is unresolved.

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

If you have any questions concerning this report, please contact John F. Riggs, Regional Inspector General for Audit, Dallas, at (972) 850-4003.

Attachment