U.S. Department of Labor

Office of Inspector General—Office of Audit

EMPLOYMENT AND TRAINING ADMINISTRATION

AUDIT OF THE SAN DIEGO WORKFORCE PARTNERSHIP, INC.

Date Issued: February 14, 2007

Report Number: 09-07-001-03-390

U.S. Department of Labor
Office of Inspector General
Office of Audit

BRIEFLY…

Highlights of Report Number: 09-07-001-03-390 to the Assistant Secretary for Employment and Training.

WHY READ THE REPORT

The report discusses the audit results for the performance audit of the San Diego Workforce Partnership, Inc. (SDWP).

WHY OIG DID THE AUDIT

The Office of Inspector General (OIG) conducted a performance audit of SDWP, an Employment and Training Administration (ETA) grantee in San Diego, California. SDWP was and continues to be the administrative agency for the Workforce Investment Board (WIB) of the City and County of San Diego, California. This audit was initiated both as a part of the OIG's audit workplan and at the specific request of the ETA Regional Administrator in San Francisco, California.

Our audit objectives were to answer the following specific questions:

1. Were SDWP grant costs accurate, allowable, and allocable?

2. Did SDWP comply with applicable laws and regulations?

3. Was SDWP's reporting of program data adequate?

READ THE FULL REPORT

To view the report, including the scope, methodology and agency response, go to:
http://www.oig.dol.gov/public/reports/oa/2007/09-07-001-03-390.pdf

FEBRUARY 2007

AUDIT OF THE SAN DIEGO WORKFORCE PARTNERSHIP, INC.

WHAT OIG FOUND

We found that SDWP grant costs were not accurate allowable and allocable. Specifically, we questioned $1.3 million in building costs and $1.3 million related to an equipment purchase-sale-leaseback transaction. We also identified $1 million in program income that SDWP considered discretionary and we requested verification of $11.6 million in direct labor and associated costs. Further, SDWP did not comply with applicable laws and regulations regarding procurement and equipment. Lastly, nothing came to our attention to indicate SDWP's controls over program data were not adequate.

WHAT AUDITEE STATED

SDWP generally did not agree that the $1.3 million of building costs were unallowable or that corrective actions were necessary on this issue. SDWP agreed that a portion of the equipment purchase-sale-leaseback transaction may be unallowable. SDWP did not agree that verifications were needed of direct labor and associated costs. SDWP did not agree the $1 million was program income but stated it had used the income for allowable program purposes. SDWP did agree to improve its procurement process and equipment records and to conduct equipment inventories every 2 years, as required.

WHAT OIG RECOMMENDED

We recommended that the Assistant Secretary for Employment and Training:

Recover $1.3 million of grant costs that were unallowable and determine the allowable cost amount related to the $1.3 million equipment purchase-sale-leaseback transaction.

Ensure that SDWP use $1 million of program income only for allowable program purposes.

Analyze $11.6 million in direct labor costs and associated charges on a grant-by-grant basis.

Direct SDWP to improve its procurement process and equipment records, and conduct equipment inventories.

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Executive Summary

The Office of Inspector General (OIG) conducted a performance audit of the San Diego Workforce Partnership, Inc. (SDWP), an Employment and Training Administration (ETA) grantee in San Diego, California. SDWP was and continues to be the administrative agency for the Workforce Investment Board (WIB) of the City and County of San Diego, California. This audit was initiated both as a part of the OIG's audit workplan and at the specific request of the ETA Regional Administrator in San Francisco, California.

Our audit objectives were to answer the following specific questions:

1. Were SDWP grant costs accurate, allowable, and allocable?

2. Did SDWP comply with applicable laws and regulations?

3. Was SDWP's reporting of program data adequate?

Our audit objectives incorporated the ETA Regional Administrator's request that we answer a number of questions and concerns regarding the costs of moving SDWP's headquarters; delinquent indirect cost proposals; unreported program income; irregular requirements for awarding contracts; and the independence of SDWP's auditing firm. Our audit included an examination of approximately $90.3 million in expenditures (Exhibit 1).

Results

We concluded that SDWP grant costs were not accurate, allowable, and allocable. In addition, SDWP did not comply with applicable laws and regulations regarding procurement and equipment. Lastly, nothing came to our attention that indicated SDWP controls over program data were not adequate.

We are specifically questioning $1.3 million for unused building space, early lease termination, and excessive rent; and $1.3 million in excessive costs related to an equipment purchase-sale-leaseback transaction. Further, we identified $1 million in unreported program income associated with charter, cash match, and conference fees. We also found that SDWP did not distribute $11.6 million in salary and related costs in accordance with OMB Circular A-122. In addition, SDWP did not submit its final indirect cost proposals as required by OMB Circular A-122.

We found that SDWP did comply with applicable laws and regulations as related to the independence of its auditing firm. However, we found that SDWP did not comply with applicable laws and regulations pertaining to procurement and equipment. Specifically, we found that SDWP: created a barrier to competition in its procurement process; did not adequately encourage the use of small businesses, minority-owned firms, and women's business enterprises; did not perform price or cost analyses for awarded contracts; did not include required information in its equipment records; and did not document physical equipment inventory or reconcile results to equipment records.

Auditee Response

SDWP generally did not agree that its grant costs were not accurate, allowable or allocable. Of the total $2.6 million we questioned for Findings 1a and 1b, SDWP stated that only $291,119 may not be allowable under governing criteria. Specifically, SDWP stated that only $134,119 in vacant retail space of the $1.3 million for unused building space, early lease termination, and excessive rent represented potentially unallowable costs. In addition, SDWP stated the unused building space, early lease termination, and excessive rent resulted from circumstances beyond SDWP's control (Finding 1a). SDWP also stated that $157,000 of the $1.3 million OIG questioned for equipment purchase-sale-leaseback represented interest charges, which may not be allowable. However, SDWP stated the remaining portion is allowable (Finding 1b).

SDWP also did not agree that the $1 million associated with charter, cash match, and conference fees represented unreported program income. However, SDWP did state that SDWP used the funds for allowable purposes for transactions occurring after the audit cutoff date (Finding 1c). Further, SDWP stated that its timekeeping system had been updated and that its salary costs were allocated reasonably in accordance with OMB Circular A-122 (Finding 1d). As to its indirect cost proposals, SDWP stated it was waiting for DOL approval on earlier rates, but has now submitted all required indirect cost proposals (Finding 1e).

SDWP did not agree that it had created a barrier to competition in its procurement process and stated that the use of certain fees had been encouraged by DOL and used in other workforce areas. SDWP also did not agree with OIG's conclusions that SDWP did not adequately encourage the use of small businesses, minority-owned firms, and women's business enterprises and that SDWP did not perform price or cost analyses for awarded contracts. However, SDWP did agree to revise its procedures in these areas to provide better documentation (Findings 2a, 2b, and 2c). Finally, while SDWP did not believe it had violated equipment regulations, SDWP concurred with OIG conclusions regarding equipment records and inventory processes and has implemented new procedures (Finding 2d).

The summary portion of SDWP's response is included in our report as Appendix D. SDWP's entire response included a summary response and 12 exhibits comprising 242 pages. Due to the volume of pages in the exhibits, we chose not to include them in our hardcopy report. However, SDWP's response in its entirety is included in our electronic copy of this report, which is available on our website at **www.oig.dol.gov**.

OIG Conclusion

OIG reviewed SDWP's responses to the draft report. The additional information provided by SDWP did not materially affect the report, although we did make small dollar adjustments to our findings. Therefore, the reported findings and recommendations remain substantially unchanged. However, based on SDWP's responses, and subject to Grant Officer concurrence, we consider recommendations 11 through 14 and recommendations 17 through 18 resolved and open, and those recommendations will be closed upon OIG's review and verification of ETA actions. We also consider recommendations 15 and 16 resolved and closed also subject to Grant Officer concurrence. The remaining recommendations 1 through 10 remain unresolved and those recommendations will be resolved during ETA's formal audit resolution process.

Recommendations

The report contains 18 recommendations to the Assistant Secretary for Employment and Training. In summary, we recommend that the Assistant Secretary:

- Recover $1.3 million in costs associated with unused building space, early lease termination, excessive rent; recover $216,850 for increased equipment lease costs that were unallowable and determine the appropriate depreciation and cost allocation of $1.1 million in equipment purchases to DOL grants; and inform SDWP that $1 million in charter fees, cash match fees, and conference registration revenue were program income and require SDWP to use those funds only for allowable program purposes. (Findings 1a through 1c)

- Require SDWP to implement corrective procedures to prevent these unallowable costs from reoccurring, perform a space utilization study to determine proper space requirements, and make determinations regarding allowable equipment and labor costs. (Finding 1b)

- Analyze $11.6 million in direct labor and associated costs, on a grant-by-grant basis, for FY 2003 through FY 2005 and determine if those costs were reasonable for the products and services received. Based upon the results of the labor cost analysis, recover any amounts determined to be unreasonable. (Finding 1d)

- Require SDWP to submit delinquent indirect cost proposals for the Department's review and approval. (Finding 1e)

- Request the Assistant Secretary for Administration and Management to complete the review and approval of SDWP's final indirect cost rates for FY 2000 and FY 2001, and, upon receipt, process for review and approval the final indirect cost proposals that SDWP will submit for FY 2002 through FY 2005. (Finding 1e)

- Direct SDWP to stop requiring charter fees and cash match fees in its procurement process. (Finding 2a)

- Require SDWP to update its procurement procedures and comply with OMB Circular A-110 requirements for utilizing small businesses, minority-owned firms and women's business enterprises, and perform cost and price analyses. (Findings 2b and 2c)

- Require SDWP to maintain equipment records in accordance with OMB Circular A-110, perform equipment inventories every 2 years, and reconcile their inventory results with equipment records. (Finding 2d)

U.S. Department of Labor

Office of Inspector General
Washington, DC 20210

Assistant Inspector General's Report

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We conducted a performance audit of the San Diego Workforce Partnership, Inc. (SDWP), an ETA grantee in San Diego, California. SDWP was and continues to be the administrative agency for the Workforce Investment Board (WIB) of the City and County of San Diego, California. This audit was initiated both as a part of the OIG's annual audit workplan and at the specific request of the ETA Regional Administrator in San Francisco, California.

SDWP is on a fiscal year ending June 30th each year. Our audit covered the period July 1, 2002 through June 30, 2004 (SDWP Fiscal Years (FY) 2003 and 2004) and included a review of $90.3 million in expenditures (Exhibit 1). We also extended our audit coverage to other periods where necessary to determine if DOL funds were properly spent.

We focused on the following three audit objectives:

1. Were SDWP grant costs accurate, allowable, and allocable?

2. Did SDWP comply with applicable laws and regulations?

3. Was SDWP's reporting of program data adequate?

Our audit objectives incorporated the ETA Regional Administrator's request to answer the following questions and concerns:

- What, if any, unallowable costs resulted from SDWP's lease, move, and space allocation at 3910 University Avenue, San Diego, CA? (Objective 1)

- Was the long-standing need to replace the out of date provisional indirect cost rates used by SDWP resolved? (Objective 1)

- Did SDWP use and treat various sources of revenue including charter fees, donations, and other refunds according to applicable regulations? (Objective 1)

- What was the impact of the requirement for One-Stop operators to pay fees as a condition of contract award? (Objective 2)

- Was the A-133 audit firm independent? (Objective 2)

We conducted the audit in accordance with the Government Auditing Standards for performance audits issued by the Comptroller General of the United States. Our audit objectives, scope, methodology, and criteria are detailed in Appendix B.

Objective 1 – Were SDWP grant costs accurate, allowable, and allocable?

Finding 1. Some SDWP grant costs were not accurate, allowable, or allocable.

SDWP did not consistently follow Federal cost principles and financial management regulations when managing DOL grant funds. Specifically, SDWP did not comply with regulatory requirements for DOL grants in the areas of leased building space, leased equipment, program income, salary cost distribution, and final indirect cost rates.

Our audit results identified questioned costs associated with:

- Unused building space, early lease termination, and excessive rent

- Excessive costs incurred for equipment purchase-sale-leaseback

- Unrecognized program income associated with charter, cash match, and conference fees

In addition, SDWP did not follow Federal cost principles concerning:

- Salary cost distribution among various DOL programs

- Timely submission of final indirect cost proposals

We identified questioned costs and funds that could be put to better use related to DOL grants. We are specifically questioning $1.3 million for unused building space, early lease termination, and excessive rent (Finding 1a) and $1.3 million for excessive costs incurred for equipment purchase-sale-leaseback (Finding 1b). We also identified $1 million in unrecognized program income associated with charter, cash match, and conference fees as funds that could be put to better use (Finding 1c). In addition, SDWP did not distribute its salary costs in accordance with OMB Circular A-122

(Finding 1d) and SDWP did not submit its final indirect cost proposals as required by OMB Circular A-122. (Finding 1e)

Finding 1a. Unused building space, early lease termination, and excessive rent

SDWP billed DOL approximately $1.3 million for costs related to unused building space, early lease termination, and excessive rent. This occurred because SDWP misinterpreted applicable rules and regulations regarding building space. As a result, SDWP misspent program funds of approximately $1.3 million comprising $763,543 in unused building space, $242,023 in early lease termination costs, and $269,586 in excessive rents.

<u>Background</u>

During 2001, SDWP, as the administrative agency for the WIB, had program operations in six separate major facilities including a One-Stop Center in the Northern part of the County (North County), a One-Stop Center in mid-town San Diego (Metro Center), and a separate building for SDWP Headquarters.

In 2001, SDWP began looking for new space for its Metro Center operations. According to SDWP officials, this was necessitated by the California Economic Development Department's (EDD) requirement to be in buildings which met certain requirements for earthquake safety. EDD was a major partner in the Metro Center and, according to SDWP officials, was required to be part of the One-Stop operations. Therefore, the entire Metro Center had to relocate.

At the time SDWP began searching for new Metro Center office space, the Metro Center, including EDD, occupied 40,000 square feet of space. In 2002, SDWP agreed to a 30-year lease on a building that was to be built specifically for SDWP that encompassed approximately 82,700 square feet, which was more than twice the amount of space previously occupied by the Metro Center (picture at right). In fact, with the Metro Center only previously occupying 40,000 square feet of space, the building was built and leased with additional purposes in mind including a portion allocated to retail space. SDWP took possession of the building in March 2004 with lease payments approximating $2 million annually. Between 2002 and March 2004, before the building was ready for occupancy, major setbacks occurred. EDD had budget and staff cutbacks and decided not to move into the new building. The community college, which had agreed to lease space, also had funding problems and decided not to execute a lease on the new building. Head Start, which had custom constructed space in the new building, also backed out. Consequently, SDWP had major occupancy problems since it was the primary leaseholder.

To solve these problems, SDWP took two major actions. First, SDWP embarked on a campaign to bring in other commercial tenants. While SDWP did obtain leases with Citibank, the California Conservation Corps and a local charter school, major parts of the building were, and still remain empty. The picture at right was taken in February 2006, and shows space that DOL funds paid for but has remained empty since March 2004. Secondly, SDWP decided to move its own Headquarters operation, which was not previously co-located with the Metro Center, to the new building. This move was not initially planned when the lease was signed.

Building expenses, with some limitations, are allowable expenses if they meet the general criteria under OMB Circular A-122 as reasonable and allocable. According to Circular A-122, a cost is reasonable if, in its nature or 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 costs. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.

SDWP incurred building expenses approximating $1.3 million that were neither reasonable nor allocable under these criteria. As detailed below, $1.3 million had been spent which was not allocable to DOL programs:

Unreasonable and/or Unallocable Building Expenses

Building Expense	Time Period	Amount
Unused Building Space	FY 2004	$ 261,892
Unused Building Space	FY 2005	501,651
Early Lease Termination	FY 2004	242,023
Excessive Rent	FY 2005	269,586
Total		**$1,275,152**

<u>Unused Building Space</u>

SDWP took possession of, and began incurring expenses on, the new building in March 2004. SDWP incurred expenses, including lease costs, facilities maintenance, and utilities for the entire building for over 3 months while the One-Stop Center was the only occupant, utilizing 31 percent of the space. The costs for the empty space, totaling $261,892, were charged directly to three DOL grants. For FY 2004, we are questioning the $261,892 in building expenses. We consider the cost of the empty building space to be unnecessary. DOL grants received no benefit by paying building expenses on the empty building space.

In addition, for FY 2005, building expenses totaling $501,651 were paid for space not used by SDWP. In October 2004, SDWP moved its Headquarters into the new building and incurred net building expenses of $1,184,670 on the new building, which were included in the FY 2005 indirect cost pool. However, the portion allocable to SDWP based on square footage translated into $683,019 being allocable to the indirect cost pool. Therefore, for FY 2005, we are questioning the difference of $501,651. (See Chart on page 10 and Exhibit 2.)

The total questioned costs for space unused by any DOL program is $763,543 ($261,892 + $501,651). Further, developing and implementing procedures to properly allocate building costs to DOL grants would prevent recurrence of unallowable costs.

Early Lease Termination

In order to fill the empty space at the new building, SDWP moved its Headquarters from its downtown location. This was not planned when the initial lease was signed, but was done because other commercial tenants could not be found to occupy the new space. However, SDWP had a lease agreement with its downtown landlord which ran through 2008. In order to move, SDWP broke the lease and paid $242,023 for the early lease termination, which was included in SDWP's indirect cost pool. Terminating the lease and moving to mitigate SDWP's rental losses on the new building was an unnecessary expense for DOL programs. Therefore, we are questioning the $242,023.

Excessive Rent

After SDWP moved its Headquarters to its new building, it occupied more space than it had in the previous location and at a greater lease cost per square foot. We conducted a rent analysis by comparing monthly rent, total area occupied, and staff levels at various specific times for SDWP's previous and current location. The total additional rent incurred as a result of moving into the new building was $269,586 as shown below:

Rent Analysis

Previous Building 1551 4th Ave		Current Building 3910 University Ave		Changes
Monthly Rent	$37,638	Monthly Rent:, (41% of total building rent)	$67,592	+79%
Total Area Occupied (SF)	24,600	Total Area Occupied (41% of 82,236 SF)	34,091	+39%
Total Employees (As of May, 2004)	71	Total Employees (As of October, 2004)	67	-6%
		Total Employees (As of February, 2006)	56 Employees	-21%

The total additional rent was computed as: $67,592 - $37,638 = $29,954 higher additional rent per month; $29,954 X 9 months (from October 2004 to June 2005) = $269,586 additional rent for FY 2005.

We concluded that there was no need to pay higher rent since the previous location was under lease until 2008 and there was no need to expand square footage since staffing levels were shrinking. As of February 2006, SDWP staff was approximately 21 percent lower than it was at the previous location. Yet SDWP had 39 percent more space at a rental cost increase of 79 percent. Therefore, we are questioning the $269,586 as excessive rent, which was unnecessary for DOL programs. In addition, a space utilization study to determine if SDWP was utilizing their space properly is critical to determining appropriate rent charges.

Auditee Response

Overall, SDWP did not agree with our audit results and conclusions. SDWP did not believe that it had misinterpreted the regulations and stated that it believed all expenses associated with the new building were both reasonable and allocable. We summarized SDWP's comments on each issue for Finding 1a in the following paragraphs.

<u>Unused Building Space</u>

SDWP disagreed that the unused building space was not reasonable or allocable expense. SDWP stated it took all reasonable steps to fill the unexpected vacant space including aggressively marketing the available space to both nonprofit and commercial tenants. SDWP also provided a detailed explanation of events, which occurred during the planning for the relocation of the One-Stop Center and SDWP headquarters. According to SDWP, the events culminating in the vacant space were not foreseeable and should be allowable as costs associated with idle facilities under OMB Circular A-122.

SDWP also computed a different amount of building costs allocable to SDWP space in FY 2005. The differences primarily related to when SDWP occupied the building space and the amount of actual space SDWP occupied. SDWP stated it occupied a portion of the building (7900 square feet) earlier in FY 2005 than OIG had calculated. There were also small differences related to a rent increase and an amount paid for tenant improvements.

SDWP conceded that the rent associated with the vacant retail space might be unallowable. The rent associated with this space was $134,119. SDWP requested that OIG reduce the questioned cost to $134,119, which SDWP agreed to resolve through the formal Department of Labor Audit Resolution Process.

SDWP also stated it has procedures in place to ensure that only allowable building space is charged to DOL grants.

Early Lease Termination

SDWP considered the early lease termination costs of $242,023 to be allowable, reasonable, and allocable. SDWP stated that due to unexpected changes with building tenants, SDWP was forced to decide between paying rent on two spaces or terminating the lease at 1551 Fourth Avenue and moving its administrative/corporate headquarters to 3910 University Avenue. SDWP concluded, based on the circumstances prevailing at the time, the decision to terminate the lease at 1551 Fourth Avenue was reasonable and allocable. However, SDWP agreed to resolve the early lease termination issue through the formal Department of Labor Audit Resolution Process.

Excessive Rent

SDWP disagreed that there was excessive rent. SDWP stated that it does not occupy more space at 3910 University Avenue than it did at 1551 Fourth Avenue. SDWP stated that the additional cost associated with rent in the new building is minimal when comparing the cost of the monthly rent for just the administrative office space at 3910 University Avenue to the previous location. SDWP stated the additional space in the new building should not be included in this comparison because it represented space needed but not provided at the old location, such as meeting rooms, a computer-training lab, and storage space. Using SDWP's calculations, the new rent is $37,768.26 as compared to $37,638 in the old building. SDWP stated the difference is minimal and should not have been classified as excessive rent.

SDWP also stated that a space utilization study is not necessary as the only vacant space at 3910 University Avenue was Suite 122, for which SDWP stopped paying rent in August 2005. However, if the Assistant Secretary for Employment and Training deems a space utilization study is necessary, SDWP will cooperate fully.

OIG Conclusion

Unused Building Space

We conclude that the costs questioned in this finding are unallowable. OMB Circular A-122 states that a cost is allocable to grants only to the extent benefits are received. DOL grants received no benefit from these costs. In addition, as SDWP states in their response, OMB Circular A-122 does allow the cost of idle facilities in certain situations where the facilities were necessary when acquired and are now idle because of changes that could not have been reasonably foreseen. However, since the Metro Center only needed about 40,000 square feet and SDWP committed itself to a 30-year lease for over 82,000 square feet, we believe the excess space was never needed for DOL related purposes.

We do not agree that the use of 7900 square feet of space prior to the SDWP move was an allowable cost. This cost related to establishing a property management office that we believe was necessitated by the decision to lease the entire building and is unrelated to DOL grants. We did make minor adjustments from the draft report to reflect rent increases and cost of tenant improvements.

After considering SDWP's response, we believe the recommendations concerning unused building space to be valid and unresolved. Also, we believe that ETA should still require a space utilization study to determine if SDWP was utilizing its space properly.

Early Lease Termination

The need to break the lease on SDWP headquarters space occurred because of the decision to lease excess space at the new building and not because of any change in program requirements. Therefore, we continue to believe the early lease termination costs are unallowable and our recommendations are still valid and unresolved.

Excessive Rent

The significant increase in rent is only partially attributable to additional space for meeting rooms, etc. As the Rent Analysis chart on page 11 of the report shows, space increased by 39 percent while total rent increased by 79 percent. Therefore, about one-half of the rent increase is due to increased space and the other half due to more expensive rent.

However, we continue to question whether any of the increase was necessary. There were no indications that SDWP moved its headquarters due to space needs or any program need. SDWP moved its headquarters due to the excess space encountered because of its decision to lease the entire new building. This resulted in a rent increase of almost $30,000 per month that, in our opinion, did not benefit DOL programs. We consider our recommendations on excessive rent to be valid and unresolved.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

1. Recover $763,543 as the cost of unused building space.

2. Require SDWP to implement procedures so that only allocable building costs are charged to DOL grants.

3. Recover $242,023 associated with the cost of early lease termination.

4. Recover $269,586 paid as excessive rent.

5. Perform a space utilization study to determine if SDWP was utilizing its space properly.

Finding 1b. Equipment Purchase-Sale-Leaseback transaction

SDWP incurred $1.3 million in costs, which were unallowable as charged for a purchase-sale-leaseback transaction. This occurred because SDWP misinterpreted the requirements of OMB Circular A-122 regarding equipment leasing costs. As a result, we are questioning $216,850 in excess cost paid on the lease as unallowable. We are also questioning the remaining $1.1 million equipment purchase price, which may have been improperly allocated to DOL grants by SDWP over the 3-year lease period.

From August 1999 to June 2000, SDWP bought various types of equipment and software from several vendors totaling $1,105,577. The purchases included such things as computer servers, website development software, and network operating system software. In August 2000, SDWP packaged and sold the equipment and software to a bank for $1,070,755, and then leased the same equipment back from the bank for 3 years. SDWP stated that it had originally intended to finance this equipment rather than purchasing it for cash. SDWP wanted to spread the purchase cost over several years but setting up the financing arrangement took time. Therefore, to get the project started, SDWP decided to purchase the equipment and then to subsequently set up a sale and leaseback. The lease payments for the 3 years totaled $1,322,427.

OMB Circular A-122 limits the Federal share of sale and leaseback transactions. Paragraph 43(b) specifically states:

> Rental costs under "sale and leaseback" arrangements are allowable only up to the amount that would be allowed had the nonprofit organization continued to own the property. This amount would include expenses such as depreciation or use allowance, maintenance, taxes, and insurance.

Therefore, the sale and leaseback presents two reimbursement problems. First, the additional leasing cost of $216,850 is unallowable as stated in OMB Circular A-122. SDWP must limit the cost to the original purchase price of $1.1 million. Secondly, SDWP charged the lease cost over a span of 3 years (2001 through 2004) instead of depreciating the original purchase price over the useful life of the equipment and software as required by OMB Circular A-122.

We did not attempt to determine the useful life of the equipment and software to compute allowable depreciation or use charges. The $1.1 million original purchase price could be allowable if SDWP appropriately computed depreciation to be charged over the useful life of the equipment and software.

Regardless of SDWP's initial intention, eligible costs are limited to the original cost of the equipment and software; therefore, the excess cost of $216,850 is questioned. In addition, the original purchase price of $1,105,577 is questioned since, as part of the lease payments, it was charged over a 3-year period instead of depreciated over the useful life of the equipment and software.

Auditee Response

Of the $216,850 in additional lease costs, SDWP agreed that $157,000 represented interest charges, which might not be an allowable cost under OMB Circular A-122, Paragraph 43(b). SDWP believes the balance of $59,850 in additional lease costs represented sales tax that would have been an allowable cost whether the equipment was leased or purchased. SDWP stated they would resolve the issue of additional lease costs through the formal DOL Audit Resolution Process.

Further, SDWP contended that the vast majority of the $1.1 million in equipment purchases were properly allocated as expenses to DOL grants. SDWP stated that of the $1.1 million in equipment purchases:

- $532,669 represented costs associated with development services and that development services did not constitute a capital asset. Therefore, development services were properly expensed over the 3-year lease.
- $460,259 represented costs for software purchase, licenses, and support. According to SDWP, information technology equipment and systems are listed as examples of "general purpose equipment" as per OMB Circular A-122, Attachment B, paragraph 15, section a (4) and capital expenditures for general purpose equipment are unallowable as direct charges, except where approved in advance by the awarding agency. (See OMB Circular A-122, Attachment B, paragraph 15, section (b) (1).) Therefore, SDWP reasoned it was correct in expensing those costs.
- $12,186 was for hardware purchases of less than $5000 and for support, both of which were properly expensed.
- $65,641 (the final amount) was spent on hardware purchases of over $5000. While SDWP agrees that the $65,641 should have been capitalized, it feels that the useful life of this equipment was 3 years. Therefore, the issue of whether or not it should have been depreciated is irrelevant.

Finally, SDWP stated all of the purchased software and equipment were used to support DOL-funded programs, and benefits accrued back to DOL, thus making the expenses allowable. Therefore, SDWP requested that OIG consider this issue to be resolved. However, if necessary, SDWP was willing to resolve the $65,641 in equipment costing over $5,000 through the formal DOL Audit Resolution Process.

OIG Conclusion

OMB Circular A-122 states that allowable costs are limited to the purchase price of the equipment. In this case, SDWP had actually purchased the equipment for $1,105,577, prior to the leaseback. Under the circumstances, this should be the maximum allowable by OMB Circular A-122. There are no provisions to add costs, such as sales tax, that "would have been paid."

Eligible equipment costs are limited to the original cost of the equipment and software; therefore, the excess leaseback cost of $216,850 is still questioned and the recommendation remains unresolved.

In regards to the depreciation of $1.1 million equipment, ETA still needs to determine if, after considering SDWP's explanations, any cost adjustments are necessary. Accordingly, the recommendation remains unresolved.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

6. Recover the $216,850 in additional lease costs.

7. Determine the appropriate allocation to DOL grants based on depreciation for the $1.1 million equipment purchase price over the useful life of the equipment and software and adjust the costs claimed accordingly.

Finding 1c. Unrecognized program income associated with charter, cash match, and conference fees

SDWP did not properly recognize revenue generated from awarding One-Stop contracts and hosting an annual conference as program income. This occurred because SDWP misinterpreted the regulations concerning program income and retained net program income for SDWP's discretionary use. As a result, SDWP did not use net program income totaling $961,490 to further program purposes as required by OMB Circular A-110. Consequently, these funds could have been put to better use to accomplish program goals such as improving employability opportunities in the San Diego area.

OMB Circular A-110 defines program income as: "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award." In addition, OMB Circular A-110, in part, requires that program income be added to funds committed to the project and be used to further eligible project or program objectives.

In awarding contracts, SDWP charged One-Stop operators what SDWP called charter fees totaling $1,055,178 and cash match fees totaling $271,687. In addition, the SDWP received a total of $100,119 in revenue for an annual conference funded by Federal grants. After paying allowable Workforce Investment Act (WIA) expenses, SDWP did not treat the remaining revenue as program income. The specifics pertaining to each program income area are discussed in the following sections.

<u>Charter Fees</u>

In FY 2000, SDWP began charging a fee (charter fee) to potential subgrantees who submitted bids on the One-Stop Center contracts. SDWP required these charter fees to be paid as a condition for bidding on the One-Stop Center contracts. The SDWP described the charter fee and related requirements to potential bidders in the Request for Proposals (RFP) for the contract on the One-Stop Centers. The RFP instructed interested bidders to submit the required charter fee as part of their bid package. Additionally, bidders were instructed to use non-federal funds to pay the charter fee and that non-successful bidders would have the fee refunded. Initially in FY 2000, the minimum amount of the charter fee was $10,000 per One-Stop contract. The amount increased each year and the maximum fee reached $50,000 per One-Stop contract in FY 2005.

The amount of the charter fee was based on the amount of the funding for the geographical area of the One-Stop identified in the RFP. SDWP set forth in the RFPs how this money was to be used. Specifically, the RFPs stated:

> The charter fee will enable the Workforce Partnership to embark on entrepreneurial initiatives that are not directly linked to WIA funding. More specifically, these discretionary funds will allow the Workforce Partnership to perform advocacy, research, and employer outreach/services. All of these activities will benefit the One-Stop Career Center Network by influencing national and State workforce policy, generating cutting-edge workforce studies, and creating strong links with San Diego County employers.

In FY 2003, SDWP began allowing One-Stop operators to submit WIA allowable expenses to SDWP for reimbursement from charter fees collected. SDWP used charter fees to reimburse $323,195 of WIA allowable expenses between FY 2003 and FY 2004. However, we did not observe any payments in FY 2005.

The following provides a snapshot of the amount of charter fee revenue collected for each year beginning in FY 2000 through FY 2005 and the amount of WIA allowable expenses paid by SDWP on behalf of the One-Stop operators.

Analysis of Charter Fees by Fiscal Year

Fiscal Year	Annual Revenue Received	Annual Payments of WIA Allowable Expenses	Annual Net Program Income
2000	$ 50,000	$ 0	$ 50,000
2001	100,000	0	100,000
2002	150,000	0	150,000
2003	150,000	99,199	50,801
2004	404,927	223,996	180,931
2005	200,251	0	200,251
TOTALS	**$1,055,178**	**$323,195**	**$731,983**

SDWP received $1,055,178 in charter fees from subgrantees and paid $323,195 in WIA allowable expenses, leaving a total of $731,983 in net program income that was not applied to the program as required by OMB Circular A-110. The program income was generated directly by the award of contracts under a WIA grant received by SDWP, and SDWP should have classified those fees as program income instead of discretionary funds. Therefore, SDWP needs to reclassify the charter fees as program income and use the funds for program purposes.

In addition to the requirements specified in OMB Circular A-110 for program income, we believe there are violations of procurement regulations. We believe that the Charter fee requirements created a barrier to open competition in the procurement process. Our concerns are discussed on pages 30 to 33 of this report. (Finding 2a)

<u>Cash Match Fees</u>

In FY 2004, SDWP began charging an additional fee for the award of the One-Stop contracts. SDWP referred to the new fee as a cash match fee. SDWP required successful One-Stop bidders to pay SDWP a fee equal to 3 percent of its region's estimated formula funding. This fee was due within 3 business days of the SDWP approval of the One-Stop contract award.

Like the charter fee, the cash match fee was required to be paid using non-federal funds. Unlike charter fees, SDWP specified in the RFP that cash match fees would be used to pay WIA eligible program expenses submitted by One-Stop operators. During the contract period, the One-Stop contractors identified certain expenditures that were to be reimbursed by SDWP using cash match funds.

We found that SDWP did collect the fees in advance and paid some expenses from the funds received. However, SDWP did not use all the cash match funds toward One-Stop operation expenses. As the following table shows, SDWP retained $129,388 in cash match fees as of the end of FY 2005:

Analysis of Cash Match Fees by Fiscal Year

Fiscal Year	Cash Match Received	Reimbursements to One-Stop Operators	Program Income
2004	$142,300	$ 94,659	$ 47,641
2005	129,387	47,640	81,747
Totals	**$271,687**	**$142,299**	**$129,388**

Despite SDWP using the cash match fees to pay program expenses, SDWP officials informed us that the funds were considered discretionary. The WIB meeting minutes stated that the WIB decided on an annual basis how to spend the funds based on staff recommendations.

In accordance with OMB Circular A-110, cash match fees should be considered program income and the fees SDWP has already collected should be used to further program purposes.

In addition to the requirements specified in OMB Circular A-110 for program income, we believe there are serious violations of procurement regulations. We specifically believe that the cash match fee requirements provided a barrier to open competition in the procurement process. Our concerns are discussed on pages 30 to 33 of this report. (Finding 2a)

Workforce Summit Revenue

In 1997, SDWP began hosting a conference, known as the Workforce Summit, to discuss issues affecting dislocated workers. This conference included attendees from regional business, government, education and training, and community leaders. In FY 2004, SDWP began charging registration and sponsorship fees to attend the conference. SDWP also received donations related to the workforce summit. In FY 2004 and FY 2005, SDWP collected registration fees, sponsorship fees, and donations totaling $200,578.

The Workforce Summit was funded by DOL grant funds. Specifically, SDWP received money to host the event from a WIA Rapid Response Grant. Consequently, the registration, sponsorship fees, and donations meet the definition of program income. OMB Circular A-110 defines program income as “gross income earned by the recipient that is directly generated by a supported activity, or earned as a result of the award.” As noted earlier, the Circular requires net program income to be used for program purposes.

SDWP, however, did not treat the registration, sponsorship fees, and donations entirely as program income as required by the Circular. We found that SDWP received $200,578 of registration, sponsorship fees, and donations from the Workforce Summit in FY 2004 and FY 2005. Of the Workforce Summit expenses totaling $442,805 for the two years, $100,459 was paid using the program income collected. The remaining $100,119 was not spent on Workforce Summit expenses. Instead, as of June 30, 2005, SDWP was still holding these funds but considered those funds to be subject to their discretionary use.

The SDWP did not consider the revenue as program income. In FY 2004, we identified a transaction where SDWP transferred $71,600 from the grant fund to a discretionary fund. In SDWP’s opinion, the revenue did not meet the definition of program income set forth in OMB Circular A-110 because SDWP considered the funds as representing donations.

We disagree. The registration, sponsorship fees, and donations meet the definition of program income provided by OMB Circular A-110. Consequently, SDWP did not comply with OMB Circular A-110.

As a result of this noncompliance with OMB Circular A-110, SDWP did not use program income totaling $100,119 to further the eligible project or program objectives. In accordance with OMB Circular A-110, this money should be used for additional job training or supportive services such as transportation or childcare.

Summary of Net Program Income

SDWP retained net program income of $961,490 from charter fees, cash match fees, and workforce summit revenue for SDWP's discretionary use instead of using the net program income for program purposes.

Source of Net Program Income

Charter Fees	$731,983
Cash Match Fees	129,388
Workforce Summit	100,119
Total Net Program Income	$961,490

Auditee Response

SDWP disagreed with the OIG that the revenue from the charter fees, cash matches, and the workforce summit should be treated as program income. However, SDWP stated that regardless of how this revenue is classified the funds were in fact spent on allowable WIA program activities.

Charter Fees

SDWP stated that charging charter fees was discussed and actually encouraged by DOL in the development of WIA. SDWP further stated that numerous models were tested and SDWP decided to adopt a model used in the Boston workforce area.

SDWP also stated "both OMB circular A-110 and 29 CFR 95.22 allow charter fees to be collected, and that those fees should not be considered program income:

> (e) Unless DOL's regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees."[1]

Further, SDWP stated that charter fees were not necessarily collected or expensed during each of the fiscal years for which they were identified and as of June 30, 2006, only $83,738 remained unspent. Consequently, SDWP requested that the OIG review submitted documentation to reflect the additional program costs in the audit report.

[1]SDWP incorrectly cited 29 CFR 95.22 in its formal comments (See Appendix D). However, Subparagraph (e), as shown above, correctly provides a partial quote of 29 CFR 95.24. OMB Circular A-110 does not contain this quote.

Cash Match Fees

SDWP stated the cash matches from non-federal sources should not be considered program income; the cash matches should be seen as a vehicle to pay for the non-federal portion of the work being done in the One-Stops; and as an opportunity to begin building the long-term sustainability of the system. SDWP believes that this interpretation is in line with the Administration's approach to leveraging resources in the President's High Growth Job Training Initiative, Community-Based Job Training Grants, and the Workforce Innovation in Regional Economic Development (WIRED) Initiatives.

SDWP stated that nothing in OMB Circular A-110 indicated the cash matches met the definition of "program income," and argued that Section 195(7)(B) of the Act would exclude cash matches as "income subject to the requirements of Section 195(7)(A)."

Workforce Summit Revenue

SDWP stated that sponsorships for the Workforce Summit were in fact charitable donations to SDWP as a 501 (c)(3) nonprofit corporation and did not constitute a form of program income. Further, SDWP stated that the interpretation of charitable donations as program income was neither the intent of the Act and such an interpretation does not support the Administration's approach to innovation. Lastly, SDWP stated that the authorizing committee in the U.S. House is considering amending the Act to clarify Congressional intent.

Given the serious program policy implications of the issues raised by OIG, SDWP requested, by separate letter, a formal policy interpretation from the Assistant Secretary for Employment and Training on whether charter fees, cash matches, and charitable donations are to be treated as program income or unrestricted revenue.

OIG Conclusion

As stated in this report, OMB Circular A-110 defines program income as "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award." In addition, OMB Circular A-110, in part, requires that program income be added to funds committed to the project and be used to further eligible project or program objectives. Since charter, cash match, and Workforce Summit fees were generated by a supported activity or earned as a direct result of the Federal awards, charter, cash match, and Workforce Summit fees must be treated as program income.

Further, SDWP's quote of 29 CFR 95.24 is incomplete. The full quote states:

> Unless terms and condition of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees and royalties for copyrighted

> material, patents, patent applications, trademarks, and inventions produced under an award (emphasis added).

The above CFR citation only applies to license fees and royalties and, in our opinion, would not include charter fees, cash match, or Workforce Summit revenues.

Charter Fees

SDWP's reference to adopting the Boston model for charter fees is inaccurate. We discussed the Boston model with ETA officials and found there were significant differences between the Boston model and SDWP's process. The key difference related to program income is that Boston charges the fees for services they perform. Boston uses the fees for program services, not discretionary purposes.

Cash Match Fees

We disagree with SDWP's definition of program income and, as previously mentioned, OMB Circular A-110 defines program income as "gross income earned by the recipient that is directly generated by a supported activity or earned as a result of the award."

Workforce Summit Revenue

We do not agree that the Workforce Summit revenues were charitable donations. SDWP asked for "sponsors" for the conference and awarded different levels of sponsorship for varying amounts of money. We did not see any information that requested a general contribution to SDWP operations unrelated to the Workforce Summit.

Overall, we do agree that if SDWP primarily used the charter, cash match, and workforce summit revenue for program purposes after our cutoff date, our recommendation regarding using the funds would be resolved. Since it occurred after our audit cutoff date, we did not verify this and ETA needs to ensure this occurred. However, since we disagreed on whether SDWP is required to treat charter fees, cash match fees, and Workforce Summit revenues as program income, the recommendation is still valid and remains unresolved.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

8. Require SDWP to account for the net charter fees of $731,983, net cash match fees of $129,388, and net workforce summit revenue of $100,119 as net program income totaling $961,490 and require that those funds be used for allowable program purposes.

Finding 1d. Noncompliance with Salary Cost Distribution System Requirements

For FYs 2003 through 2005, SDWP did not distribute $11.6 million in employee salaries and associated costs to grants based on actual time spent on the grants in accordance with OMB Circular A-122. Instead, predefined percentages based on estimates were used to distribute salaries of employees who worked on multiple grants. This occurred because, prior to FY 2006, SDWP's salary cost distribution system did not comply with OMB Circular A-122 requirements. Without a proper salary cost distribution system, there was insufficient assurance that all salary costs charged to DOL grants prior to FY 2006 were accurate.

OMB Circular A-122 Attachment B requires that:

> (1). . . .The distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph (2)...
>
> (2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards.
>
>> (a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. *Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards. (Emphasis added.)*

Prior to FY 2006, the salary cost distribution system did not record employees' actual work time on each of the DOL grants. Instead, salary cost distribution was done within the accounting process based on percentages. Those percentages were generally established at the beginning of each fiscal year based on estimated time each employee would spend on each grant during the fiscal year. According to SDWP officials, those estimates would be adjusted during the year if circumstances changed.

As noted earlier, however, this does not comply with OMB Circular A-122 which requires salary cost distribution to be based on an after-the-fact determination of actual time spent on the grants. As a result, the distribution of salary costs was unsupported.

To determine whether employees worked on the grants their salaries were charged to, we judgmentally selected four SDWP employees for interviews whose salaries were charged to multiple grants. In our interviews we asked the employees what grants they worked on and the estimated percentage of time spent on each grant.

All employees said they worked on the grants to which their salaries were charged. However, three of the four employees provided estimates of the percentage of time spent on each grant that varied from the percentages used by SDWP. The following charts show these variances.

Employee Time Allocation Analysis

Program	Employee A	
	Budgeted by SDWP	Estimated by Employee
Youth at Work 03-04	10%	10%
Grossmont STC 04-05	25%	15%
Price Charities	15%	15%
SUHSD STC 04-05	50%	60%
Total	100%	100%

Program	Employee B	
	Budgeted by SDWP	Estimated by Employee
Earmark-P	10%	15%
Bio Science	80%	85%
General	10%	0%
Total	100%	100%

Program	Employee C	
	Budgeted by SDWP	Estimated by Employee
Bio Science	50%	10%
Rapid Response 04-05	50%	65%
General	0%	25%
Total	100%	100%

We recognize that employee estimates may not be any more accurate than SDWP's budgeted percentages; however, the variances support the need to record actual time spent on each grant.

SDWP's salary costs for grants were significant. For FY 2003 through FY 2005, SDWP administered approximately 40 grants and incurred direct grant salary charges approximating $11.6 million. Since Congress mandates how funds for each program must be spent, it is critical that salary costs be distributed accurately to those grants.

At the beginning of FY 2006, SDWP changed its salary cost distribution system and made the necessary changes to distribute salary costs based on the actual hours worked for each grant. However, using the criteria in OMB Circular A-122, SDWP's grant salary costs prior to FY 2006 are considered inadequately supported.

Auditee Response

SDWP stated it has updated its timekeeping system. The updated timekeeping system now strictly complies with OMB Circular A-122 Attachment B; however, SDWP asserted that its prior methodology with respect to timekeeping was allowable under OMB Circular A-122.

SDWP stated it based employee's payroll allocations on discussions with directors who gave reasonable estimates of time in percentages to the finance department. These reasonable estimates of time were reviewed when the budget was modified. Each reasonable estimate of time was based on the projects in individual departments. SDWP contended that the chart in our report entitled "Employee Time Allocation Analysis" supports its assertion that reasonable estimates of time were made. SDWP also believes this methodology is allowable under A-122.

SDWP also stated that salary costs were reviewed each time they submitted a grant application and were never deemed to be unreasonable. SDWP believed that the methodology used provided a "reasonable estimate".

Finally, SDWP stated they performed a preliminary analysis, on a grant-by-grant basis, of the $11.6 million in direct labor costs and associated charges for FY 2003 through FY 2005. The analysis revealed that 54 percent (or $6.3 million) of employee labor was 100 percent dedicated to a single cost objective. Therefore, SDWP requested that the OIG reduce the amount recommended for analysis from $11.6 million to $5.3 million, which is the most that was charged to multiple grants over the period.

OIG Conclusion

SDWP's labor cost distribution system did not meet one critical requirement of OMB Circular A-122. The Circular specifically requires that time reports must reflect an *after-the-fact* determination of the actual activity of each employee. SDWP based its allocations on *before-the-fact* determinations. OMB Circular A-122 specifically states "budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards." Therefore, we consider the charges unsupported.

The reasonableness of the $11.6 million in allocated labor costs and associated charges still needs to be resolved. Our recommendations remain unresolved until this is accomplished.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

9. Analyze $11.6 million in direct labor costs and associated charges on a grant-by-grant basis for FY 2003 through FY 2005 and determine if those costs were

reasonable for the products and services received.

10. Based upon the results of the labor cost analysis, recover any amounts determined to be unreasonable in relation to the products and services received.

Finding 1e. Noncompliance with Indirect Cost Proposal Requirements

From FY 2002 through FY 2005, SDWP did not comply with OMB Circular A-122's indirect cost proposal requirements. Specifically, SDWP did not submit its final indirect cost proposals to DOL for approval. This occurred because SDWP was waiting for approval and feedback from DOL on previously submitted final indirect cost proposals before submitting the remaining proposals. Since SDWP had not submitted its final indirect cost proposals, SDWP's actual grant costs could not be computed for the periods FY 2002 through FY 2005. However, using the actual but unsubmitted rates developed by SDWP for that period, we estimated $5.9 million in overpayments may be refundable as of June 30, 2005.

OMB Circular A-122 establishes criteria for indirect cost reimbursement. The Circular allows grantees to develop a provisional indirect cost proposal based on estimates to calculate temporary rates for billing indirect costs during a fiscal year. The Circular then requires grantees to prepare a final indirect cost proposal within 6 months after the close of the fiscal year using actual costs for the year. Further, the Circular requires grantees to submit the final indirect cost proposal to its major Federal funding agency for approval. Accordingly, grantees such as SDWP should recalculate grant indirect costs from provisional amounts to actual costs based on the final approved rate.

SDWP had not met these criteria for the last 4 years. SDWP's final indirect cost proposal was due December 31st following each fiscal year. As of April 2006, SDWP had not submitted the required indirect cost proposals for FY 2002 through FY 2005.

SDWP was waiting for the approval and feedback from DOL on previously submitted final indirect cost proposals before submitting additional proposals for FY 2002 through FY 2005. SDWP had previously submitted final indirect cost proposals, but had not received DOL approval for those proposals. Although SDWP had calculated its final indirect cost rates for those periods, SDWP wanted to resolve any problems with DOL before submitting any additional indirect cost proposals.

The delay in submitting final indirect cost proposals may be having a material effect on grant costs. The following table shows the approved provisional rates; the final rates SDWP proposed; and the potential $5.9 million in overpayments.

Potential Indirect Cost Overpayments

	Total Direct Costs Base	SDWP Proposed Final Indirect Rate	Approved Provisional Indirect Rate	Proposed Final Indirect Rate less Approved Provisional Indirect Rate
FY 2002	$16,899,003	42.15%	67.93%	($4,356,053)
FY 2003	$22,074,202	22.77%	42.15%	($4,276,903)
FY 2004	$15,510,841	24.79%	22.77%	$ 312,629
FY 2005	$9,607,219	47.86%	22.77%	$2,410,442
Totals				**($5,909,885)**

As the table shows, there is over $5.9 million in potential overpayments over 4 years. However, it should be noted the SDWP's proposed final indirect cost rates have not been approved by DOL and could be higher or lower when finalized. In addition, DOL has not approved final indirect cost rates for at least 2 years prior to FY 2002, which would also affect any potential overpayments.

Auditee Response

On September 28, 2006, SDWP submitted its final indirect cost proposals for FY 2002 through FY 2005 to the Office of Cost Determination. SDWP also stated that during FY 2002 through FY 2005 SDWP did not allocate costs based on the proposed final indirect rates but instead allocated based on actual costs incurred.

Further, SDWP stated that its indirect costs never exceeded more than 15% of SDWP's annual budget. SDWP stated that its defined indirect costs have evolved over the years, resulting in a change in methodology for FY 2006. For the past 2 years, cost pools were developed to identify direct relationships to certain grants, and activity-based costing was used to pool expenses directly to program activities. This methodology, developed in conjunction with the Office of Cost Determination, has resulted in a reduction of indirect costs.

SDWP believes that the "Potential Indirect Cost Overpayment" chart shown in the OIG report is not accurate given the packages submitted to the Office of Cost Determination. In SDWP's opinion, the $5.9 million in potential indirect cost overpayments bears no actual relationship to the costs actually incurred and allocated by SDWP. Further, SDWP believes that no overpayment occurred. Once SDWP receives approval of the final indirect cost proposals it will take appropriate actions as necessary to reconcile its books.

OIG Conclusion

OIG confirmed that the Division of Cost Determination had received SDWP's indirect cost proposals for the fiscal years ending June 30, 2002 through June 30, 2005. Therefore, we consider these recommendations resolved and open. The recommendations will be closed when SDWP makes any necessary adjustments to grant costs.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

11. Require SDWP to submit final indirect cost proposals for FY 2002 through FY 2005 to DOL for approval of SDWP's indirect cost rates for those years.

12. Request the Assistant Secretary for Administration and Management to complete the review and approval of SDWP's final indirect cost rates for FY 2000 and FY 2001, and, upon receipt, process for review and approval the final indirect cost proposals that will be submitted by SDWP for FY 2002 through FY 2005.

13. Require SDWP to recalculate its indirect costs based upon the DOL approved final indirect cost rate and make adjustments as needed for any over- or under-payments.

Objective 2 – Did SDWP comply with applicable laws and regulations?

Finding 2. SDWP did not comply with all applicable laws and regulations.

SDWP did comply with applicable laws and regulations, including OMB Circular A-133, as related to the independence of its auditing firm. We reviewed the concerns expressed by the ETA Regional Administrator regarding SDWP's auditing firm's potential independence conflict. We concluded that SDWP's auditing firm met the independence requirements established by the American Institute of Certified Public Accountants and by OMB Circular A-133.

However, SDWP did not comply with applicable laws and regulations pertaining to procurement and property management. Specifically, we found that:

a. SDWP created a barrier to competition in the procurement process for soliciting and awarding One-Stop contracts by requiring improper charter and cash match fee assessments. (Finding 2a)

b. SDWP did not adequately solicit small businesses, minority-owned firms, and women's business enterprises. (Finding 2b)

c. SDWP did not perform price or cost analyses for contracts awarded. (Finding 2c)

d. SDWP equipment records did not contain all information required by OMB Circular A-110. Additionally, SDWP did not document its physical inventory of equipment or reconcile results to equipment records. (Finding 2d)

As a result, (1) SDWP awarded One-Stop contracts in excess of $9 million for FY 2004 without maximum competition, and could not assure DOL received the best services for the best price, (2) small businesses, minority-owned firms, and women's business enterprises may not have been utilized to the maximum extent possible in SDWP's $32.2 million in procurements for FYs 2003 and 2004, (3) there is a lack of assurance that contract cost was appropriate, and (4) DOL funds could be negatively impacted from incomplete and inaccurate equipment records.

Finding 2a. The SDWP created a barrier to competition in the procurement process for soliciting and awarding One-Stop contracts by requiring improper charter and cash match fees.

As previously discussed in Objective one,[2] the SDWP required charter and cash match fees as a part of the awarding of One-Stop contracts. This occurred because the SDWP considered charter and cash match fees useful in executing entrepreneurial initiatives not directly related to WIA funds and raising discretionary funds. Consequently, by imposing those fees, the SDWP created a barrier to competition, which is prohibited by OMB Circular A-110. Further, organizations interested in bidding on the One-Stop contracts that did not have non-federal funds required by SDWP lost an opportunity to bid on the contracts. In addition, without reviewing bids from all potential organizations interested in One-Stop operations, the SDWP may not have selected the operators with the most innovative and effective approach to One-Stop operations. Finally, SDWP may not have received the best services for the best price.

OMB Circular A-110 established procurement requirements that DOL nonprofit grantees must follow. Specifically OMB Circular A-110 requires, in part, that "all procurement transactions be conducted in a manner to provide, to the maximum extent practical, open and free competition." SDWP did not meet these requirements. Specifically, SDWP required the selected bidders to submit charter and cash match fees as a condition of the award of One-Stop contracts.

The charter fees were cash payments all bidders had to pay at the time of submitting a bid in order to be considered for the award of the contract. The cash match fees were cash payments selected bidders had to pay within 3 days of being awarded the contract. SDWP required both fees to be paid using non-federal funds. The amounts required were computed in two different ways: charter fees were based on the funding for the One-Stop's geographical area and varied from $10,000 to $50,000 per bid. Charter fees were refundable to bidders not selected. Cash match fees were set at 3 percent of the One-Stop funding and varied from about $25,000 to $50,000 for the selected bid.

SDWP set forth in the RFPs how this money was to be used. Specifically, the RFPs stated:

[2]See pages 17 to 23 in this report.

> The charter fees will enable the Partnership to embark on entrepreneurial initiatives that are not directly linked to WIA funding. More specifically, these discretionary funds will allow the Workforce Partnership to perform advocacy, research, and employer outreach/services.

For the cash match fee, the RFP identifies the fee as another funding source. The RFP also stated that the cash match fees would be used to offset career center operating costs.

To determine if imposing the charter and cash match fees established a barrier to competition in the One-Stop procurement process, we interviewed SDWP personnel, representatives of organizations who had indicated their intent to bid, and One-Stop operators.

During our interviews, SDWP management stated that SDWP held public forums and invited public comments concerning the fees and that no objections were raised. SDWP management did not believe the fees created a barrier.

Potential contractors disagreed with SDWP management's position. We identified 20 organizations that previously indicated their intent to bid on the One-Stop contracts. We were able to contact 14 of these organizations. Ten of the organizations contacted stated that the fees were definitely a barrier to their participation and the organizations were unable to participate in the One-Stop procurement process because they could not afford the fees. These were primarily nonprofit organizations that did not have the cash up front yet felt strongly that they were able to provide the services required. Several indicated that they had expressed their concerns to SDWP but to no avail.

Four of the 14 were successful bidders who had paid the charter and cash match fees and received a contract. Even so, virtually every one of the organizations indicated they either had problems raising the cash or questioned the practice as part of competitive procurement. Overall, interviewees strongly disagreed with the SDWP practice of charging the fees in the award of the One-Stop contracts and questioned the legality of the practice.

We concluded that the charter and cash match fees created a barrier to competition for the One-Stop procurement process. SDWP awarded One-Stop contracts in excess of $9 million for FY 2004 without maximum competition and could not assure DOL received the best services for the best price.

As a result, SDWP may not have obtained the best One-Stop services for the best price. Barriers may have prevented some qualified organizations from providing what may have been an innovative approach to One-Stop operations. For example, one organization prevented from bidding because of the fees was already a successful job training contractor with DOL. SDWP lost the opportunity to consider this organization's job training experience.

Auditee Response

SDWP disagreed with OIG that a barrier to competition was created in the procurement process for soliciting and awarding One-Stop contracts by requiring charter and cash match fees. SDWP stated charter and cash match fees in and of themselves are not improper. SDWP cited Boston, among other workforce areas, as collecting charter fees since 1998, and stated DOL has been encouraging cash matches, or leveraged resources, in its most recent procurements.

SDWP stated that, in the calendar period 2000 through 2004, they held extensive public hearings prior to releasing their first Request for Business Plans (RFBP) and had not heard any objections to charging charter or cash match fees. SDWP also stated they felt it was a reasonable prerequisite for any successful bidder on the procurement. They felt the RFBP procurement was not the usual procurement and warranted special provisions. Specifically, SDWP stated:

> SDWP does want to emphasize that the RFBP was not a traditional request for proposal that would normally be issued for a service provider. SDWP was seeking organizations that could not only run a multi-million dollar enterprise, but could prove that they could also bring other partners – not subcontractors – to the table, in addition to the 17 mandated by the Job Training Partnership Act, and provide a true business plan on how the scope of the One-Stops could be expanded. SDWP felt, and still feels, that if a bidder could not leverage $10,000 in non-federal dollars from its partners it was/is unlikely that they would be successful. This approach seems in accordance with DOL's policy initiatives.

SDWP stated that its program performance and One-Stop system had been used as a national benchmark and SDWP believes that, in fact, bidders were chosen who are innovative, effective, and cost efficient.

Finally, SDWP noted that because of the concerns raised by OIG, SDWP stopped levying charter and cash match fees effective July 1, 2006, and will continue to do this until the issue is resolved. Therefore, SDWP requested that OIG consider the finding resolved. However, SDWP has raised this serious policy issue in a separate letter to the Assistant Secretary for Employment and Training requesting a policy interpretation on the allowability of charging charter fees and encouraging cash matches from non-federal sources outside of the procurement process.

OIG Conclusion

We continue to believe the charter and cash match fees created a barrier to competition for the One-Stop procurement process. As noted in the report, we interviewed companies that did not bid on the procurements, ones that did but were not successful, and ones that were successful. All expressed concern over the charging of charter and cash match fees. These concerns may have prevented some qualified organizations from providing what may have been an innovative approach to One-Stop operations. Therefore, we still conclude SDWP awarded One-Stop contracts in excess of $9 million for FY 2004 without maximum competition and could not assure DOL received the best services for the best price.

In regards to the example of the Boston workforce area charter fee practices, SDWP again makes an inappropriate comparison. While the Boston area has charged “charter fees,” the requirements for when they are paid, how they are paid, and how the money was used is significantly different. For example, in Boston, bidders are not required to pay the fees in advance just to be able to bid. There are other differences, which make the two situations alike in title only.

Based on the SDWP actions to stop charging charter and cash match fees, we consider the recommendation resolved and open. The recommendation will be closed, subject to Grant Officer’s concurrence, when ETA issues their policy interpretation on the allowability of charging charter fees and encouraging cash matches from non-federal sources outside of the procurement process.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

14. Require SDWP to stop charging charter and cash match fees as part of the One-Stop contract award process.

Finding 2b. SDWP did not adequately encourage the use of small businesses, minority-owned firms, or women’s business enterprises.

SDWP did not adequately encourage the use of small businesses, minority-owned firms, or women’s business enterprises during their procurement process for FYs 2003 and 2004. Specifically, SDWP did not perform all of the procedures required by OMB Circular A-110 regarding small businesses, minority-owned firms, and women's business enterprises. This occurred because SDWP’s procurement procedures did not include all of the provisions of OMB Circular A-110. As a result, during FYs 2003 and 2004, small businesses, minority-owned firms, and women’s business enterprises may not have been fully utilized in SDWP’s contracting for $32.2 million in procurements. In addition, SDWP may have lost an opportunity for innovative approaches for services and products.

During FYs 2003 and 2004, SDWP conducted numerous procurement actions in providing employment services for the San Diego area. Those procurement actions approximated $32.2 million and included contracts for One-Stop operations, service agreements for website development, and purchase orders for printing services. The individual procurement actions ranged in dollar value from $25,000 to $2.4 million.

OMB Circular A-110 requires that grantees make positive efforts to utilize small businesses, minority-owned firms, or women's business enterprises whenever possible. Section 44 (b) states “Recipients of Federal awards shall take <u>all of the following steps</u> (emphasis added) to further this goal.

> (1) Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.
>
> (2) Make information on forthcoming opportunities available and arrange time frames for purchases and contracts to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises.
>
> (3) Consider in the contract process whether firms competing for larger contracts intend to subcontract with small businesses, minority-owned firms, and women's business enterprises.
>
> (4) Encourage contracting with consortiums of small businesses, minority-owned firms and women's business enterprises when a contract is too large for one of these firms to handle individually.
>
> (5) Use the services and assistance, as appropriate, of such organizations as the Small Business Administration and the Department of Commerce's Minority Business Development Agency in the solicitation and utilization of small businesses, minority-owned firms, and women's business enterprises.

To evaluate SDWP’s compliance with these requirements, we reviewed the SDWP procurement process and tested a statistical sample of 12 procurement actions, which totaled $9.6 million, out of 25 processed during FY 2003 and FY 2004,. Those 12 procurements ranged in dollar value from $25,000 to $2,451,145.

For the 12 sampled procurement actions, SDWP did make information available on forthcoming opportunities to encourage and facilitate participation by small businesses, minority-owned firms, and women's business enterprises by maintaining a mailing list of small businesses, minority-owned firms and women’s business enterprises. However, SDWP did not take any of the other positive steps related to small businesses, minority-owned firms, and women’s business enterprises required by OMB Circular A-110.

We found that the SDWP procurement process did not include all actions required by OMB Circular A-110. None of the 12 sampled procurement actions tested showed that SDWP: considered whether firms competing intended to subcontract with small businesses, minority-owned firms, or women's business enterprises; encouraged contracting with consortiums of small businesses, minority-owned firms and women's business enterprises; or used the services of the Small Business Administration and the Department of Commerce's Minority Business Development Agency.

For example, in one contract worth $2,451,145 processed in FY 2004 for One-Stop services, the contractor subcontracted for more than $346,000 of services. However, according to the contractor, SDWP never asked the contractor about using small businesses, minority-owned firms, and women's business enterprises or asked them to make any special efforts as required by OMB Circular A-110.

Overall, SDWP procurement policies and procedures did not address all of the requirements of OMB Circular A-110 concerning small businesses, minority-owned firms, and women's business enterprises. In fact, SDWP procurement policies and procedures were completely absent of any mention of small businesses, minority-owned firms, and women's business enterprises.

As a result, during FY 2003 and 2004, small businesses, minority-owned firms, and women's business enterprises may not have been utilized to the maximum extent possible in SDWP's contracting for $32.2 million in procurements. In addition, SDWP may have lost an opportunity for innovative approaches for services and products.

Auditee Response

SDWP stated it has revised its procurement guidelines in accordance with OMB Circular A-110 and will ensure that the revised guidelines are implemented by December 31, 2006. SDWP will ensure that steps are taken to identify small businesses, minority-owned firms, and women's business enterprises, and utilize their services to the greatest extent possible, whether as a prime or subcontractor.

OIG Conclusion

OIG considers SDWP's actions adequate and consider this recommendation resolved and closed, subject to Grant Officer's concurrence.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

15. Require SDWP to update procedures to comply with OMB Circular A-110's requirements for small businesses, minority-owned firms, and women's business enterprises.

Finding 2c. SDWP did not perform price or cost analyses for contracts awarded.

SDWP did not comply with OMB Circular A-110's requirements to perform a cost or price analysis. Specifically, during FYs 2003 and 2004, SDWP issued 25 contracts totaling $32.2 million and we estimated that 81 percent of those contract actions did not have cost and price analyses executed. We believe this occurred because SDWP misinterpreted the requirements of OMB Circular A-110. As a result, SDWP may not have received the best value for the services and products procured during the 2-year period. In addition, SDWP did not have assurance that costs were reasonable, allowable, and allocable.

OMB Circular A-110 requires that: "Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action." The Circular defines cost analysis as the review and evaluation of each element of cost to determine reasonableness, allocability, and allowability. According to the Circular, a price analysis may be accomplished in various ways including comparing price quotations, market prices, and similar indicia.

To evaluate SDWP's compliance with these requirements, we reviewed the SDWP procurement process and tested a statistical sample of 12 procurement actions, which totaled $9.6 million, out of 25 processed during FYs 2003 and FY 2004,. Those 12 procurements ranged in dollar value from $25,000 to $2,451,145.

We reviewed the procurement actions to determine whether SDWP performed a cost analysis to evaluate whether costs were reasonable, allocable, and allowable. We also determined if SDWP had performed a price analysis by comparing price quotes, market prices, or other price data.

We found that SDWP did not perform a cost or price analysis on 11 of the 12 procurement actions reviewed. There was no documentation in the procurement files that SDWP had considered whether costs were reasonable, allocable, or allowable. Further, there were no indications that any form of price analysis was executed.

For example, in one procurement, SDWP purchased software development services costing $205,000. This cost included licensing fees, maintenance fees, and associated labor services. However, SDWP did not document any cost analysis of these elements of cost as required by OMB Circular A-110. In addition, SDWP did not document any price analysis showing comparison of price quotes, market prices, or other pricing data. Therefore, there is a lack of assurance that this cost was reasonable, allowable, and allocable or that the price reflected best value.

In another example, SDWP procured website development services for $1.7 million. The cost of the procurement included separate costs for a calendar and event management system, product registration, and a job matching system. However, again SDWP did not document any cost analysis or price analysis of these elements of cost as required by OMB Circular A-110. Therefore, there is a lack of assurance that this contract cost reflected best value.

We estimated that SDWP did not perform cost or price analyses for 81 percent of the procurement actions executed in FYs 2003 and 2004. Therefore, we concluded that SDWP lacked assurances that the costs of products and services procured during the 2-year period were reasonable, allowable, and allocable. In addition, SDWP may not have received the best value for those services and products.

Auditee Response

SDWP stated it has already revised its internal procurement guidelines so that better documentation is maintained through the procurement cycle, and that documentation clearly demonstrates that the costs of what was procured were "reasonable, allowable, and allocable," per OMB Circular A-110 or that the price reflects best value. SDWP staff will be informed of the new procurement guidelines through in-house training seminars, to ensure that throughout the organization there is clear and uniform understanding of the expectations of the procurement process.

OIG Conclusion

We reviewed and determined the revised guidelines were adequate. Consequently, this recommendation is considered resolved and closed, subject to Grant Officer's concurrence.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

16. Require SDWP to establish procedures to perform and document a cost and price analysis for each procurement.

Finding 2d. Equipment records did not contain all information required by OMB Circular A-110. Additionally, SDWP did not document their physical inventory of equipment or reconcile results to equipment records.

SDWP did not comply with OMB Circular A-110's requirement to maintain accurate and complete records on equipment and to perform an inventory on equipment every 2 years. Specifically, SDWP did not have accurate and complete equipment records and could not provide any documentation of when a complete physical inventory was taken. This occurred because SDWP's policies and procedures did not incorporate OMB Circular A-110's requirements. Without adequate information or biennial inventories, it is possible that equipment could be diverted to non-program purposes without approval or that equipment could be disposed of without appropriate credit to Federal programs.

According to OMB Circular A-110 Subpart C Section 34 (f) (3), "A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every 2 years." Additionally, OMB Circular A-110 Subpart C section 34 (f) (1) requires that equipment records shall be maintained accurately and shall include information, such as a description of the equipment, identifying numbers, award number, location, purchase date, and purchase cost, etc.

We found SDWP had incomplete equipment records. Although SDWP 's inventory system has the capacity to record all the required information as stated in OMB Circular

A-110, SDWP did not consistently complete and update the following required information: source, award number, location, condition and inventory date.

The following table shows the information missing from the inventory list:

Missing Inventory Information

Required Information	Number of Equipment Missing Information	Percentage of Total Equipment	Total Value
Fund Source	3	13 percent	$ 20,675
Award Number	16	70 percent	$ 391,091
Location	10	43 percent	$ 156,416
Condition	3	13 percent	$ 20,675
Inventory Date	18	78 percent	$ 136,450

SDWP stated it had done an inventory as required. However, no documentation was provided to support their statements. From SDWP's equipment records, we conducted a 100 percent physical inventory of their accountable equipment (over $5,000) that was purchased with DOL funds. We could not locate 5 of 23 equipment items totaling $44,714. For example, we could not locate two Toshiba copiers costing $7,489 and $7,709, respectively. The equipment records did not show if they were sold, became obsolete, or was otherwise disposed of by SDWP. If these copiers were disposed of, there was no clear record of when they were released, how they were disposed of, or if funds were received for it. DOL could be due a credit if funds were received for the copiers. The same is true for the other equipment. These conditions and the information missing from SDWP records could negatively impact DOL funds.

Auditee Response

SDWP stated it has updated its equipment records to include all the information as required by OMB Circular A-110 and will perform and document an equipment inventory every 2 years and reconcile the inventory to equipment records.

OIG Conclusion

SDWP response is adequate and this recommendation is considered resolved and open. The recommendation will be closed after ETA confirms that the new inventory system meets the requirements of OMB Circular A-110.

Recommendations

We recommend that the Assistant Secretary for Employment and Training:

17. Require SDWP to update its equipment records to include all the information required by OMB Circular A-110.

18. Perform and document an equipment inventory every 2 years and reconcile the inventory to equipment records.

Objective 3 – Was SDWP's reporting of program data adequate?

Most of the WIB activities in San Diego, CA were contracted out and SDWP, as the administrative agency for the WIB, was responsible for managing and monitoring each award supported by DOL grants. Therefore, we focused our audit on SDWP's controls over and processes for monitoring program performance reporting to determine whether SDWP had adequate controls in place to ensure program data were accurate. This program data included participants served, participant eligibility, and levels of service provided.

We conducted a workpaper review of SDWP's independent auditing firm to determine the extent that firm reviewed SDWP's monitoring of its program data and whether SDWP's monitoring and reporting was adequate. We also interviewed SDWP program personnel to gain an understanding of the controls over program monitoring and reporting. In addition, we reviewed SDWP's monitoring program to determine if review procedures were adequate. Finally, we tested performance reports to determine if SDWP filed required timely and accurate program reports.

SDWP has a very structured process for monitoring program performance. SDWP developed an extensive software program which requires contractors to input performance data within 3 days of the accomplishment, which makes this data immediately available to SDWP monitors. In addition, SDWP hired an independent auditing firm to perform agreed-upon procedures on program operations, including program data.

Based on our review, nothing came to our attention that indicated SDWP's reported performance data were not accurate.

Elliot P. Lewis

Elliot P. Lewis
April 6, 2006

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Exhibits

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EXHIBIT 1

SDWP GRANT EXPENDITURES (JULY 1, 2002 THROUGH JUNE 30, 2004)

Salaries, Wages, and Benefits	$ 8,776,889
Temporary Staff	105,492
Advertising	10,573
Outreach	382,047
Contractual Services	3,775,879
Software & Application Development	3,220,935
Equipment	1,921,506
Facilities	1,810,777
Meeting	283,761
Office Supplies	327,820
Professional Fees	172,655
Staff Training and Development	86,844
Travel	232,009
Job Fairs	15,592
Allocation - Indirect Costs	8,819,112
Allocation - Career Center	1,664,321
Program expenses - Contractors	58,720,960
Total Expenditures	$90,327,172

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EXHIBIT 2

FY 2005 NET BUILDING EXPENSES ALLOCABLE TO INDIRECT COST POOL

TOTAL FY 2005 BUILDING RENTAL/LEASE COSTS[3]			**$ 941,782.71**
Facilities Maintenance Costs	$171,198.34		
Utilities	$ 71,689.20		
Total Maintenance and Utilities Costs			**$ 242,887.54**
NET BUILDING EXPENSES CHARGED TO THE FY 2005 INDIRECT COST POOL			**$1,184,670.25**
RENT CALCULATIONS FOR FY 2005			
Rent from Oct. 04 to June 05 (Time of Occupancy)	9 months		
Monthly Rent as per Lease Agreement at 3910 University Ave (New Building)	$164,859.57		
SDWP's Percentage Portion Based on Occupied Space	41%		
SDWP's Allocated Portion of Rent Per Month (41% of Monthly Rent)	$ 67,592.42		
Eligible Rent for 9 Months Building Was Occupied (9 times Monthly Rent Allocation of $67,592.42)			**$ 608,331.78**
MAINTENANCE & UTLITIES COSTS CALCULATIONS FOR FY 2005			
Total Maintenance and Utilities Costs for FY 2005	$ 242,887.54		
SDWP's Percentage Portion Based on Occupied Space	41%		
SDWP's Allocated Portion of Rent Per Month (41% of Total Maintenance & Utilities Costs)	$ 99,583.89		
Eligible Maintenance and Utilities Per Month ($99,583.89 divided by 12 months)	8,298.66		
Eligible Maintenance and Utilities for 9 months (9 times Monthly Costs of $8,298.66)			**74,687.92**
NET BUILDING EXPENSES ALLOCABLE TO THE INDIRECT COST POOL			**$683,019.70**
QUESTIONED COSTS DIFFERENCE[4]			**$ 501,650.55**

[3]Net rental expense after revenue collected from other commercial tenants such as Charter School, Citibank, and California Conservation Corps.
[4]See Chart on page 10 and discussion of unused building space on pages 10 and 11 in this report.

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Appendices

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APPENDIX A

BACKGROUND

The Workforce Investment Act (WIA) established a comprehensive range of workforce development activities through state and local organizations. Available workforce development activities provided in local communities can benefit job seekers, laid off workers, youth, incumbent workers, new entrants to the workforce, veterans, persons with disabilities, and employers.

The purpose of these activities is to promote an increase in employment, job retention, earnings, and occupational skills by participants. This, in turn, improves the quality of the workforce, reduces welfare dependency, and improves the productivity and competitiveness of the nation. California received approximately $454 million from the Federal Government in 2004-2005 to provide services for adults, laid-off workers, and youth.

The San Diego Workforce Partnership (SDWP) acts as the administrative agency for the San Diego Workforce Investment Board (WIB) and has been administering job training and employment programs for the region's residents and businesses for more than 30 years.

SDWP was created under a Joint Powers Agreement by the City and County of San Diego. The mission of the SDWP is to coordinate a comprehensive workforce development system that ensures a skilled, productive workforce and supports a healthy economy throughout the San Diego region. SDWP receives Federal, state and local funding to provide workforce development activities that: 1) increase individuals' employment, retention and earnings, as well as skills; and 2) are responsive to employers' needs and provide for economic development.

The SDWP is a nonprofit organization with about 56 employees and an annual budget of approximately $46 million. The SDWP serves all of San Diego City and County, and has six full-service One-Stops operated by a combination of for profit and nonprofit agencies.

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APPENDIX B

OBJECTIVES, SCOPE, METHODOLOGY, AND CRITERIA

Objectives

The primary audit objectives were to answer the following questions:

(1) Were SDWP grant costs accurate, allowable, and allocable?

(2) Did SDWP comply with applicable laws and regulations?

(3) Was SDWP's reporting of program data adequate?

In addressing the audit objectives, we responded to the ETA Regional Administrator's request and answered the following audit questions:

i. What, if any, unallowable costs resulted from SDWP's lease, move, and space allocation at 3910 University Avenue, San Diego, CA? (Objective 1)

ii. Was the long standing need to replace the out of date provisional indirect cost rates used by SDWP resolved? (Objective 1)

iii. Did SDWP use and treat various sources of revenue including charter fees, donations, and other refunds according to applicable regulations (Objective 1)

iv. What was the impact of the requirement for One-Stop operators to pay fees as a condition of contract award? (Objective 2)

v. Was the A-133 audit firm independent? (Objective 2)

Scope

Our performance audit covered SDWP FYs 2003 and 2004 (July 1, 2002 through June 30, 2004). For questioned costs, we expanded our audit scope to earlier and later periods as identified in our findings. That work was limited to quantifying the dollar impact of identified problems.

We conducted our audit in accordance with Government Auditing Standards for performance audits issued by the Comptroller General of the United States. A performance audit includes an understanding of internal controls considered significant to the audit objectives and testing compliance with significant laws, regulations, and other compliance requirements. In order to plan our audit, we considered whether internal controls significant to the audit were properly designed and placed in operation.

Also, we conducted a review of SDWP's FYs 2003 and 2004 audits to determine the extent to which we could rely on their work.

We conducted the audit at SDWP offices in San Diego, California, at the independent auditor's offices in Irvine, California, and at selected subcontractor offices in the San Diego area. Fieldwork was conducted from November 26, 2005 to April 6, 2006.

Methodology

We used the President's Council on Integrity and Efficiency's Guide to evaluate the work of the independent auditor. Our review was performed to avoid duplication; to build upon the work performed by the independent auditor; and to obtain an understanding of the internal controls used by SDWP to safeguard and manage assets and to report costs to DOL. We examined and evaluated their work related to the SDWP financial statements, including the Statement of Federal Grant Costs, and major compliance issues set forth under OMB Circular A-133.

To supplement the internal control work of the independent auditor, we developed and applied an internal control questionnaire specifically for our audit. Based on the results of our internal control analysis, subsequent risk analysis, and specific ETA concerns, we decided to perform additional financial work on the lease of the new SDWP building, payroll cost distribution, program income, financial reporting and indirect costs. We also decided to perform additional compliance testing on procurement and equipment and to confirm our understanding of internal controls over performance reporting.

To determine if SDWP properly accounted for the building lease, we inspected accounting records and made onsite observations, including reviewing floor plans.

To determine the amount of program income, we examined accounting records and procurement documents related to charter fees, cash match fees, and economic summit revenue. We interviewed SDWP officials as to the collection and application of these revenues and reviewed WIB and Policy Board minutes for information related to the revenues. We also interviewed non-awardees to determine whether the requirements for charter and cash match fees impacted their ability to compete for contract awards.

To determine the salary cost distribution process we interviewed SDWP accounting personnel and examined selected accounting records. We also interviewed four SDWP employees regarding the time they spent on various projects.

To determine if indirect cost rates were properly applied and accounted for, we obtained the indirect cost proposals prepared by SDWP, examined DOL approvals, and discussed the indirect cost proposal process with the DOL Cost Negotiator. We also reviewed the independent auditor's application of indirect cost rates.

We also assessed the financial reporting process and tested the reliability and validity of the financial status reports SDWP filed with DOL.

To evaluate the independence of SDWP's auditing firm, we obtained and reviewed their service contracts to determine the scope of services provided. We then compared these determinations to rules established by the American Institute of Certified Public Accountants to conclude on whether the auditing firm met all independence standards.

To determine if charter and cash match fees presented a barrier to competition in the award of One-Stop contracts, we reviewed the Request for Proposals for the contracts and identified the bidding requirements. We then interviewed non-awardees and successful bidders to obtain feedback on the effect, if any, of requiring these fees as part of the procurement process.

To test compliance with procurement requirements, we selected a statistical sample of procurement actions in consultation with the OIG statistician. We randomly selected a sample of 12 procurement actions out of total 25 total procurement actions to meet our audit objective. We also reviewed procurement files and conducted interviews with SDWP management to understand the procurement actions.

Specifically, we reviewed the sampled procurement files and discussed the individual procurement actions with SDWP officials regarding the use of small businesses, minority-owned firms and women's business enterprises and overall compliance with the procurement requirements of OMB Circular A-110.

To assess equipment management procedures at SDWP, we performed inventory testing of 100 percent of the equipment over $5000. We made onsite visits to SDWP offices and subcontractor sites to visually identify equipment existence and use. We also reviewed SDWP's inventory and accounting records related to equipment.

Principal Criteria

In addressing the audit objectives, we reviewed relevant Federal laws, regulations, and guidance. These included the following:

- OMB Circular A-110 - Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

- OMB Circular A-122 - Cost Principles for Non-Profit Organizations

- OMB Circular A-133 - Audits of States, Local Governments, and Non-Profit Organizations

- The Workforce Investment Act (WIA) of 1998

- Applicable SDWP grant agreements

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APPENDIX C

ACRONYMS AND ABBREVIATIONS

CFR	Code of Federal Regulations
DOL	Department of Labor
EDD	California Economic Development Department
ETA	Employment and Training Administration
FY	Fiscal Year
OMB	Office of Management and Budget
OIG	Office of Inspector General
RFP	Request for Proposal
SDWP	San Diego Workforce Partnership, Inc.
WIA	Workforce Investment Act
WIB	Workforce Investment Board
SDCCD	San Diego Community College District

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APPENDIX D

AUDITEE RESPONSE TO DRAFT REPORT

SAN DIEGO
WORKFORCE
PARTNERSHIP®
Creating Workforce Solutions℠ for the San Diego Region

November 17, 2006

Mr. Ralph McClane
Assistant Regional Inspector General
Office of Inspector General
71 Stevenson Street
Suite 720- Office of Audit
San Francisco CA 94105

Dear Mr. McClane:

San Diego Workforce Partnership's response to the final draft of the Office of Inspector General's Audit, dated October 10, 2006, is attached. While Workforce Partnership does not agree with all of the findings of the OIG auditors, I want to assure you that the staff and members of Workforce Partnership's Board of Directors takes each of the findings very seriously, and we are committed to resolving any outstanding issues as expeditiously as possible. I believe that you will find our responses to the OIG's findings to be thoughtful and thorough.

As you know, this has been a long and difficult process. However, I would be remiss if I did not compliment the professionalism of the OIG staff that spent so many months at our offices. Throughout the process they kept an open mind, and were always willing to listen to our explanations. I also want to thank the OIG for what I feel is a very balanced and fair audit report. Again, while Workforce Partnership does not agree with all of the findings, I do appreciate the way in which the findings were presented, as well as the fact that the OIG included the strengths of our monitoring system and the work of our Independent Auditor.

Thank you for your patience. We look forward to receiving the final audit report.

Sincerely,

Lawrence G. Fitch
President & CEO

Attachment

3910 University Avenue • Suite 400 • San Diego, CA 92105-1326
TEL (619) 228-2900 • TDD (619) 228-2983 • FAX (619) 228-2901 • www.SanDiegoAtWork.com

Executive Summary
San Diego Workforce Partnership (SDWP) Response

Since receiving the draft audit report from OIG, SDWP has been carefully reviewing it and evaluating the findings. SDWP has reviewed its internal procedures where applicable and has taken corrective action steps that were deemed appropriate (discussed in detail in the body of SDWP 's response). SDWP will actively work with the Office of Inspector General, the National and Regional Offices of the Department of Labor, and The California Employment Development Department (EDD) to resolve these issues. It is SDWP's intent to resolve these issues as quickly as possible.

Finding 1.
Some SDWP grant costs were not accurate, allowable or allocable.

Finding 1a.
Unused building space, early lease termination, and excessive rent

SDWP Response
SDWP respectfully submits that it did not misinterpret applicable rules and regulations regarding building space.

Background
The Metro Career Center located on Aero Drive consisted of 53,000 square feet including 17,812 square feet of space occupied by the San Diego Community College District. This is important to note because originally the San Diego Community College District was to occupy 8848 square feet of space at the Metro Career Center on University Avenue.

Also important to note is that at the time the University Avenue site was being designed all other career centers in San Diego County were operating at full capacity and the center on Aero Drive was struggling to find space to accommodate all meetings and trainings that were taking place. Further, EDD had informed the Workforce Partnership that, due to seismic requirements imposed on State agencies through an Executive Order, it could no longer occupy its space on Aero Drive, and wanted to work with SDWP in finding a new location.

Planning for 3910 University Avenue took place over a period of more than two years. EDD, Neighborhood House Association (as operator of HeadStart), and the San Diego Community College District all intended to occupy space at 3910 University Avenue. Documentation supporting each of these organizations intent to occupy space in the building is attached as SDWP Exhibit A.

The parts of 3910 University Avenue that remain empty are the childcare suite and Suite 122 – both on the first floor of the building. SDWP has not been paying rent on these spaces since August 2005. BR Workforce LLC, the owner of the building, is entering

Page 1 of 18

into a direct lease with the Chicano Federation for the childcare space and SDWP is currently negotiating an amendment to the Master Lease reducing the amount of square footage for which it is responsible. Though outside the time period of this audit, SDWP feels it important to note that it has tried on multiple occasions to renegotiate its lease with BR Workforce LLC with no success.

As OIG points out, building expenses are allowable, with some exceptions, if they meet the general criteria under OMB Circular A-122 as reasonable and allocable. According to Circular A-122, a cost is reasonable if, in its nature or 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 costs. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.

SDWP respectfully contends that all expenses associated with 3910 University Avenue are allowable as all costs were both reasonable and allocable. The move from Aero Drive to University Avenue took several years to plan. As noted above, one of several major factors that lead to SDWP moving the Metro Career Center was that EDD, an integral partner in the one stop, could not continue to occupy space at the Aero Drive location because it did not meet state seismic requirements. To bring the Aero Drive location into compliance with the state seismic requirements was cost prohibitive.

During the 2-plus year planning period, SDWP lined up subleases including those with EDD, SDCCD, and Neighborhood House Association. Due to unforeseen catastrophic budget cuts both EDD and Neighborhood House Association were unable to enter into a sublease for space in the building. SDCCD was unable to enter into a sublease due to a bond proposition that precluded it from leasing space. Discussions about the possibility of condominizing the building so that SDCCD could purchase the entire fourth floor took place between SDCCD and the building owner at the time, San Diego Revitalization Corporation. Unfortunately, the condominimization did not occur and SDCCD could not purchase any space.

SDWP took all reasonable steps to fill the unexpected vacant space at 3910 University, including aggressively marketing the available space to both nonprofit tenants and commercial tenants, and moving its headquarters from downtown San Diego into the City Heights building.

As for the costs of 3910 University Avenue being allocable, OMB Circular A-122 is quite clear:

4. Allocable costs.

a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

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> (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or
>
> (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

SDWP believes that the costs for the utilization of the space at 3910 University meets the above tests and therefore are allocable.

<u>Unused Building Space</u>
SDWP agrees with OIG that the amount of rent related to unused building space for FY 2004 was $261,892.

In its analysis of the building space not used by SDWP after it occupied the new building from October 2004 through June 2005, OIG's calculations are incorrect. Attached as SDWP Exhibit B are SDWP's revised calculations. The reason for the difference between the two calculations is due in large part to the fact that SDWP had always planned to occupy a portion of the building (7900 square feet) that OIG did not include in its figures.

OMB Circular A-122 paragraph 21 discusses idle facilities and idle capacity. It states that the "costs of idle facilities are unallowable except to the extent that: …

> (2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination or other causes which could not have been reasonable foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease or dispose of such facilities."

Though SDWP agrees unused building space rent for FY 2004 and agrees to its revised number for FY 2005, SDWP maintains that other than the vacant retail space, all other space should be treated as idle facilities under OMB Circular A-122 paragraph 21 subpart 2 and the costs should be allowed. As stated above, the causes of the idle facilities were such that they could not have reasonably been foreseen.

<u>Early Lease Termination</u>
SDWP concedes that the cost to terminate the lease for 1551 Fourth Avenue was $242,023. However, SDWP considers these costs as allowable as they were reasonable at the time they were incurred and were allocable. Because of the unexpected changes with building tenants, SDWP was forced to decide between paying rent on two spaces, one of which would have been indefinitely vacant, or terminating the lease at 1551 Fourth Avenue and moving its administrative/corporate headquarters to 3910 University. Based on the circumstances prevailing at the time, the decision to terminate the lease at 1551 Fourth Avenue was reasonable and allocable.

<u>Excessive Rent</u>
On a pure square footage basis, SDWP does occupy more space at 3910 University Avenue than it did at 1551 Fourth Avenue. The space at 3910 University Avenue contains additional meeting room space, a computer-training lab, and storage space. Prior to the move to 3910 University Avenue, many meetings were held off-site due to

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lack of meeting space, including a monthly all staff meeting, and off-site storage space was utilized. A more accurate comparison of space is to look at the entire 4th floor of University Avenue versus the entire space at 1551 Fourth Avenue, which shows a decrease in space for SDWP administrative offices. This comparison produces the results below in the revised Rent Analysis chart.

Rent Analysis

Previous Building 1551 4th Avenue		Current Building 3910 University Avenue		Change
Monthly Rent	$37,638	Monthly Rent*	$37,768.26	Less than 1/2 % increase
Total Area Occupied	24,600	Total Area Occupied	16,638	32% decrease
Total Employees (as of May 2004)	71	Total Employees (as of October 2004)	67	6% decrease
		Total Employees (as of February 2006)	56	21% decrease

**In order to compare apples to apples, the previous building rental should be compared against only the fourth floor rent. SDWP relocated staff from 1551 Fourth Avenue to 3910 University Avenue. At that time, SDWP was already occupying space on floors 1-3.

OIG Recommendations:
We recommend that the Assistant Secretary for Employment and Training:

1. Recover $773,380 as the cost of unused building space.

2. Require SDWP to implement procedures so that only allocable building space cost is charged to DOL grants.

3. Recover $242,023 associated with the cost of early lease termination.

4. Recover $266,400 paid as excessive rent.

5. Perform a space utilization study to determine if SDWP was utilizing its space properly.

SDWP Responses to OIG Recommendations:

1. As to Recommendation 1, SDWP respectfully corrects OIG's calculations regarding the unused building space for FY 2005, as indicated on SDWP Exhibit B. The largest amount of cost that OIG can question is $703,881.55, as opposed to the $773,380 OIG has listed. However, based on the discussions above, SDWP believes that the $703,881.55 is allowable as the costs were both reasonable and allocable. SDWP concedes that the rent associated with the vacant retail space may be unallowable. The rent associated with this space is $134,119. SDWP respectfully asks that OIG reduce the questioned cost to $134,119, which SDWP

agrees to resolve through the formal Department of Labor Audit Resolution Process.

2. As to Recommendation 2, SDWP respectfully submits that it has procedures in place to ensure that only allowable building space is charged to DOL grants and requests that OIG consider this recommendation resolved.

3. As to Recommendation 3, SDWP believes that the $242,023 associated with the early lease termination should stand. The costs were both reasonable and allocable. However, SDWP agrees to resolve this issue through the formal DOL Audit Resolution Process.

4. As to Recommendation 4, SDWP offers that the cost associated with excessive rent is minimal when comparing apples to apples as stated above and as shown in the revised Rent Analysis chart. The cost of the monthly rent for the administrative/corporate office space at 3910 University Avenue is $37,768.26 as compared to $37,638. The difference between the two rents is minimal and SDWP respectfully requests that it not be classified as excessive rent and that the charges be allowed to stand.

5. SDWP respectfully suggests that a space utilization study is not necessary. The only vacant space at 3910 University is Suite 122 – for which SDWP stopped paying rent in August 2005. Should the Assistant Secretary for Employment and Training deem a space utilization study necessary, SDWP will cooperate fully.

Finding 1b.
Equipment Purchase-Sale-Leaseback transaction
OIG Recommendations:

6. We recommend that the Assistant Secretary for Employment and Training: Recover the $216,850 in additional lease costs.

7. Determine the appropriate allocation to DOL grants based on depreciation for the $1.1 million equipment purchase price over the useful life of the equipment and software and adjust costs claimed accordingly.

SDWP Response to OIG Recommendations:

6. As to Recommendation 6, of the $216,850, SDWP has determined that $157,000 represents interest charges. SDWP concurs that the $157,000 may not be an allowable cost under OMB Circular A-122 Paragraph 43(b). As to the remaining $59,850, SDWP believes at least some portion of that represents sales tax that would have been paid on the transaction whether it took the form of a purchase or a lease and that sales tax is an allowable expense. Therefore, SDWP respectfully requests that the OIG reduce the

questioned amount under this recommendation to $157,000, which SDWP agrees to resolve through the formal DOL Audit Resolution Process.

7. As to Recommendation 7, SDWP respectfully contends that the vast majority of the almost $1.1 million equipment purchase was properly allocated as expenses to DOL grants.

   Of the $1,070,754.61, $532,668.60 represents costs associated with development services. Services do not constitute a capital asset and therefore were properly expensed over the three-year lease. Another $460,259.24 of payments represents costs for software purchase, licenses and support. Information technology equipment and systems are listed as examples of "general purpose equipment" (See OMB Circular A-122, Attachment B, paragraph 15, section a(4)) and "capital expenditures for general purpose equipment are unallowable as direct charges, except where approved in advance by the awarding agency." (See OMB Circular A-122, Attachment B, paragraph 15, section (b)(1).) Therefore, SDWP is correct in expensing the costs associated with these types of equipment and systems and should not have capitalized and depreciated it.

   Of the remaining $77,826.77, $12,185.79 is from hardware purchases of less than $5000 and support, both of which were properly expensed. The final $65,640.98 was spent on hardware purchases of over $5000. While SDWP agrees that this amount should have been capitalized as these purchases do represent capital assets, it feels that the useful life of this equipment was three years and therefore the issue of whether or not it should have been depreciated is irrelevant. See SDWP Exhibit C for details on all payments under this lease-back transaction.

   Further, all of the software and equipment under this transaction was used to support DOL-funded programs, and benefits accrued back to DOL, thus making the expenses allowable. Therefore, SDWP respectfully requests that OIG consider this issue to be resolved. However, if necessary, SDWP is willing to agree to resolve the $65,640.98 in equipment over $5,000 through the formal DOL Audit Resolution Process.

Finding 1c.
Unrecognized program income associated with charter, cash match, and conference fees

SDWP Response
While SDWP may not have considered funds from charter fees, cash match fees or Workforce Summit revenue as program income; the funds were in fact used for programs in San Diego County and were spent for allowable expenses.

Charter Fees
SDWP has completed an analysis of Charter Fees by fiscal year and has attached it, along with backup General Ledger documentation, at SDWP Exhibit D. SDWP agrees that a total $1,055,178 of revenue was collected for the periods of FY 00-01 through FY 05-06. However, the funds were not necessarily collected or expensed during each of the fiscal years for which they were identified.

As SDWP Exhibit D shows, the revenue received was reduced by revenue refunded to organizations that were not selected as operators of the One Stop Career Centers and by revenues that were transferred to programs and into the cash match fee account. In this instance some of the fees were improperly recorded initially and SDWP's finance department has corrected and properly adjusted these accounts.

SDWP Exhibit D also shows additional expenses that were not reflected in OIG's analysis on page 15 of the draft audit report. It is important to note that the scope of OIG's audit ended on 6/30/2005 and that during FY 05-06 an additional $483,625.50 was paid out for program purposes ($478,216.79 of which was allocated to the One Stop Career Centers). As of 6/30/06, the Charter Fee account has a balance of $83,737.51. SDWP would appreciate OIG reviewing SDWP Exhibit D and reflecting these program costs in their audit report.

Cash Match Fees
SDWP spent the Cash Match Fees on program-related activities. SDWP agrees that $271,687 was collected between FY 03-04 and FY 04-05 and that the balance in the Cash Match account at the end of FY 04-05 was $129,387.58. However, SDWP does not agree with the column on page 16 of the draft audit titled Reimbursements to One-Stop Operators. SDWP has provided a revised Analysis of Cash Match Fees by Fiscal Year Chart and back-up GL documentation – See SDWP Exhibit E.

Also here, because OIG's audit period ended 6/30/05 payments made to One Stop Career Center operators after 6/30/05 are not reflected in the draft audit. SDWP distributed $126,996.84 to One Stop Career Center operators during FY 05-06 and the Cash Match account has a balance of $2390.74 remaining. SDWP would appreciate OIG reviewing SDWP Exhibit E and reflecting these costs in their audit report.

Workforce Summit Revenue
SDWP respectfully disagrees with OIG's assertion that $100,119 was not spent on Workforce Summit expenses. SDWP has retained only $11,846.44 related to the Workforce Summit. See SDWP Exhibit F for details. SDWP would appreciate OIG reviewing the information contained in SDWP Exhibit F and updating their audit report.

SDWP received two separate grants from EDD to help fund the Workforce Summit events. The first grant received (5263 FY03-04) was for $92,337.00 and the second grant received (5264 FY04-05) was for $250,000.00, totaling $342,337.00. SDWP also collected registrations and sponsorships (non-grant revenue) for both events in the amount of $211,592.33. Therefore, SDWP had combined total revenue of $553,929.33.

The Summit events generated a total of $357,796.79 in expenses. SDWP used $158,050.90 ($92,337.00 from 5263 and $65,713.90 from 5264) in grant revenue and $199,745.89 in non-grant revenue to pay for theses expenses. Therefore, by subtracting the $357,796.79 in expenses from the $553,929.33 in revenue, the balance is $196,132.54 in revenue. However, of the $196,132.54 in remaining revenue, $184,286.10 ($250,000 – $65,713.90) in grant revenue was carried over into FY05-06 for other programs within the grant budget, which leaves an available balance of $11,846.44 in unused money as of 06/30/2005.

The $11,846.44 can also be calculated by subtracting the non-grant expenses of $199,745.89 from the non-grant revenue of $211,592.33.

OIG Recommendations:

8. OIG recommends that the Assistant Secretary for Employment and Training: Require SDWP to account for the net charter fees of $731,983, net cash match fees of $129,388, and net economic summit revenue of $100,119 as net program income totaling $961,490 and require that those funds be put to better use for allowable program purposes.

SDWP Response to OIG Recommendation:

8. As to Recommendation 8, as noted above, SDWP feels that, regardless of how the net income from charter fees, cash matches and the annual Workforce Summit is classified, the funds were, in fact, spent on allowable WIA program activities, including those activities required under section 117(d) of the Act. However, SDWP continues to respectfully disagree with the OIG that the revenue from the charter fees, cash matches and the Workforce Summit should be treated as program income.

   The history of SDWP charging charter fees began with the early discussion on developing legislation to replace the Job Training Partnership Act. In numerous meetings with then-Assistant Secretary of ETA Doug Ross, Mr. Ross often recommended that local workforce areas treat the developing one-stop systems in their areas as 'franchises,' and that the local areas could levy "franchise fees."

   During the early implementation phase of the Workforce Investment Act, numerous models were tested for leveraging resources, including the City of Boston developing a Request for Business Plan approach, and the charging of charter fees to one-stop operators. The fees were $75,000 per center. The Boston model was the approach SDWP decided to adopt. (The issue of whether SDWP violated procurement procedures by requiring charter fees and cash matches will be addressed in Finding 2a/Recommendation 13.)

SDWP maintains that both OMB circular A-110 and 29 CFR 95.22 allow charter fees to be collected, and that those fees should not be considered program income:

(e) Unless DOL's regulations or the terms and conditions of the award provide otherwise, recipients shall have no obligation to the Federal Government with respect to program income earned from license fees.

In fact, local governments and non-profit joint-powers agencies (as is SDWP) that receive federal funds do charge various franchise-type fees (cable TV, port fees, airport fees, etc.) that are then used as general revenue. As SDWP feels the one-stop model developed by it is unique, SDWP takes the position that 95.22 should apply to charter fees.

SDWP also believes the cash matches from non-federal sources should not be considered program income, but be seen as a vehicle to pay for the non-federal portion of the work being done in the one-stops, and as an opportunity to begin building the long-term sustainability of the system. SDWP believes that this interpretation is in line with the Administration's approach to leveraging resources in the President's High Growth Job Training Initiative, Community-Based Job Training Grants and the WIRED Initiatives. We respectfully submit that nothing in OMB Circular A-110 seems to indicate the cash matches meet the definition of "program income," and argues that Section 195(7)(B) of the Act would exclude cash matches as "income subject to the requirements of Section 195(7)(A)."

Finally, SDWP continues to respectfully disagree with OIG that charitable donations in the form of sponsorships to a 501 (c)(3) nonprofit corporation constitute a form of program income. There is no mention as such in OMB Circular A-110, and such an interpretation would inhibit corporations and foundations from supporting workforce development programs. As with the Charter Fees and Cash Matches above, SDWP also feels that charitable donations do not meet the program income requirements of Section 195(7)(B). Further, SDWP believes that such an interpretation is neither the intent of the Act nor in keeping with the Administration's approach to innovation. In fact, the authorizing committee in the U.S. House is considering amending the Act to clarify Congressional intent:

Sec. 195(7)(D) Notwithstanding the requirements of this or any other laws, regulations, or OMB circulars governing resource contributions to federal programs, funds received by a public or private nonprofit entity that are not described in paragraph (B), such as funds contributed by philanthropic foundations, businesses, or other private entities, shall not be considered to be income under this title, and shall not be subject to the requirements of this Act. Such private funds may be used for any initiatives, as determined appropriate by the recipient that promote the basic interests and outcomes of this Act and the economic growth of their state and region. The use of such funds may include but not be limited to –

(i) local leadership initiatives (such as the convening of stakeholders, brokering of services, serving as an intermediary, etc.)

(ii) addressing the workforce investment and economic needs of the state or local community;

(iii) the leveraging of other public and private resources for workforce initiatives; and

(iv) new and innovative workforce strategies and initiatives.

While the recipient shall describe such privately financed activities in their annual reports, they are not required to obtain prior authorization before using such private, non-public funds.

Given the serious program policy implications of the issues raised by OIG, SDWP has requested a policy interpretation from the Assistant Secretary of the Employment and Training Administration by separate letter.

As to Recommendation 8, SDWP would respectfully request that OIG accept that in this instance the net 'program income' has been appropriately accounted for and consider this finding resolved. Further, SDWP requests that the Assistant Secretary issue a formal ruling on whether the charter fees, cash matches and charitable donations are to be treated as program income or unrestricted revenue. SDWP has raised this serious policy issue in a separate letter to the Assistant Secretary of Employment and Training Administration, requesting a policy interpretation.

Finding 1d.
Noncompliance with Salary Cost Distribution System Requirements

SDWP Response

SDWP has updated its timekeeping system. The updated timekeeping system now strictly complies with OMB Circular A-122 Attachment B; however, SDWP continues to assert that its prior methodology with respect to timekeeping was allowable under A-122.

SDWP acknowledges that payroll allocations based on budgeted amounts are not allowed under A-122. SDWP contends that this was not the methodology used. Employee's payroll allocations were based on discussions with directors who gave reasonable estimates of time in percentages to the finance department. These reasonable estimates of time were reviewed when the budget was modified. Each reasonable estimate of time was based on the projects in individual departments. SDWP respectfully contends that the chart on page 19 of OIG's draft audit entitled "Employee Time Allocation Analysis" supports its assertion that reasonable estimates of time were made. SDWP believes this methodology is allowable under A-122.

OIG Recommendations:

9. We recommend that the Assistant Secretary for Employment and Training: Analyze $11.6 million in direct labor costs and associated charges on a grant-by-grant- basis for FY 2003 through FY 2005 and determine if these costs were reasonable for the products and services received.

10. Based upon the results of the labor cost analysis, recover any amounts determined to be unreasonable in relation to the products and services received.

SDWP Response to OIG Recommendations:

9. As to Recommendation 9, SDWP programs have been repeatedly monitored by the state and federal monitors over the years. There have been no claims that programs have not been run efficiently or that the State or Federal government disagreed that the programs were properly provided. See SDWP Exhibit G for copies of monitoring reports.

   In addition, SDWP's salary costs were reviewed each time we submitted a grant application or responded to an SFP and were never deemed to be unreasonable. Finally, as noted above, and as is noted in OMB Circular A-122, Section 7. m(2)(c): "The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents ***a reasonable estimate*** (emphasis added) of the actual work performed by the employee during the periods covered by the reports" and SDWP believes that the methodology used meets the "reasonable estimate" requirement. However, if the Assistant Secretary wishes to conduct an analysis of these direct labor costs SDWP will provide any and all necessary documentation and cooperate in all ways to resolve this finding quickly.

   Preliminary analysis of $11.6 million in direct labor costs and associated charges on a grant-by-grant basis for FY 2003 through FY 2005 shows that 54.0% of employee labor was 100% dedicated to a single cost objective. Therefore, there was not any differentiation on their time card for the entire year. See SDWP Exhibit H for detailed time charging analysis. Additional backup documentation can be made available to OIG and/or DOL if it is deemed necessary.

10. As to Recommendation 10, SDWP believes that amounts charged to grants during FY 2003 through FY 2005 were reasonable in relation to the products and services produced and that no amount should be recovered. However, if ETA concludes in their review that adjustments are necessary, SDWP will make the necessary adjustments. SDWP respectfully requests that OIG reduce the $11.6 million to $5.3 million which is the most that

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OIG should examine since that is the amount of labor charged to multiple grants over the period examined.

Finding 1e.
Noncompliance with Indirect Cost Proposal Requirements

SDWP Response
On September 28, 2006, SDWP submitted its final indirect cost proposals for FY 2002 through FY 2005 to the Office of Cost Determination. Please note that during FY 2002-2005 SDWP did not allocate costs based on the proposed final indirect rates but instead allocated based on actual costs incurred. Indirect costs never exceeded more than 15% of SDWP's annual budget.

The manner in which SDWP defines indirect costs has evolved over the years, with a change in methodology for FY 2006. Cost pools have been developed to identify direct relationships to certain grants, where the specific rather than indirect definition is used. For the past two years SDWP has used activity-based costing though this pooling of expenses directly linked to program activities. This has resulted in a reduction of indirect costs, developed in conjunction with the Office of Cost Determination.

SDWP believes that the "Potential Indirect Cost Overpayment" chart is not accurate given the packages submitted to the Office of Cost Determination. The $5.9 million bears no actual relationship to the costs actually incurred and allocated by SDWP. Further, SDWP believes that no overpayment occurred. Once SDWP receives approval of the final indirect cost proposals it will take appropriate actions as necessary to reconcile its books.

OIG Recommendations:

11. Require SDWP to submit final indirect cost proposals for FY 002 through FY 2005 to DOL for approval of SDWP's indirect cost rates for those years.

12. Request the Assistant Secretary for Administration and Management to complete the review and approval of SDWP's final indirect cost rates for FY 2000 and FY 2001, and, upon receipt, process for review and approval the final indirect cost proposals that will be submitted by SDWP for FY 2002 through FY 2005.

13. Require SDWP to recalculate its indirect costs based upon the DOL approved final indirect cost rate and make adjustments as needed for any over- or under- payments.

SDWP Response to OIG Recommendations:

11. As to Recommendation 11, SDWP has complied with OIG's recommendation and on September 28, 2006 submitted its final indirect cost proposals for FY 2002 through FY 2005 to the Office of Cost Determination. The proposals were hand-delivered to the Cost Negotiator assigned to SDWP. See SDWP Exhibit I for confirmation letter from the Division of Cost Determination. Therefore, SDWP respectfully requests the OIG consider this issue to be resolved.

12. As to Recommendation 12, since hand delivering the final indirect cost proposals, SDWP has been in contact with the Cost Negotiator and believes final rates will be forthcoming. SDWP will continue to cooperate with the Cost Negotiator and will provide any additional documentation needed in a timely manner.

13. As to Recommendation 13, SDWP will ensure that all appropriate adjustments are made once final indirect cost rates are received. At this point, after a number of discussions SDWP believes that there will not be any necessary adjustments because during FY 2002-2005 SDWP did not allocate costs based on the proposed final indirect rates but instead allocated based on actual costs incurred. However, as indicated above, SDWP will continue to work diligently with the Cost Negotiator to resolve this finding.

Finding 2.
SDWP did not comply with all applicable laws and regulations.

Finding 2a.
SDWP created a barrier to competition in the procurement process for soliciting and awarding One-Stop contracts by requiring improper charter and cash match fees.

OIG Recommendation:

13. Require SDWP to stop charging charter and cash match fees as part of the One-Stop contract award process.

SDWP Response to OIG Recommendation:

13. As to Recommendation 13, SDWP respectfully disagrees with OIG that a barrier to competition was created in the procurement process for soliciting and awarding one-stop contracts by requiring improper charter fees and cash matches. As noted in the response to Finding 1c and Recommendation 8, charter fees and cash matches in and of themselves

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are not 'improper.' Boston, among other workforce areas, has been collecting charter fees since 1998, and the U.S. Department of Labor (USDOL) has been encouraging cash matches, or 'leveraged resources' in its most recent procurements. For example, in DOL's July Solicitation for Proposal release for the Community-Based Job Training grants, as announced in the July 3, 2006 Federal Register, Volume 71, no. 127, it noted that projects funded by their grants should leverage resources, and that such resources should come from both federal and non-federal sources. While USDOL did not directly require that applicants leverage resources, points were awarded in the evaluation process to applicants who did.

4. *Leveraged Resources*. Projects funded through CBJTGs should leverage resources from key entities in the strategic partnership. Leveraging resources in the context of strategic partnerships accomplishes three goals: (1) It allows for the strategic pursuit of resources; (2) it increases stakeholder investment in the project at all levels including design and implementation phases; and (3) it broadens the impact of the project itself. Applicants are encouraged to leverage significant resources from key partners and other organizations to maximize the impact of the project on the community. Leveraged resources include both Federal and non-Federal funds and may come from many sources. Businesses, faith-based and community organizations, economic development entities, education systems, and philanthropic foundations often invest resources to support workforce development. … ETA encourages CBJTG applicants and their strategic partners to be entrepreneurial as they seek out, utilize, and sustain these resources, whether they are in-kind or cash contributions, when creating capacity building and training strategies to effectively address the workforce challenges identified by industry.

2. Linkages to Key Partners (20 Points)
The applicant must demonstrate that the proposed project will be implemented by a strategic partnership that includes at least one entity from each of four categories. … The applicant must identify the partners by organizational name and category, explain the meaningful role each partner will play in the project, and document the resources leveraged from each partner. Collaborating partners must verify their role through a letter of commitment detailing the roles, responsibilities, and resources the partner will commit to the project. The letters of commitment must be attached to the proposal. Applicants should also identify resources leveraged from other organizations, including other workforce investment system partners. ETA encourages, and will be looking for, applications that go beyond the minimum level of partnership and demonstrate broader, substantive and sustainable partnerships. Scoring on this criterion will be based on the following factors:
• *Comprehensiveness of the Partnership (7 Points):* The applicant must explain the meaningful role each partner will play in the project. Points for this factor will be awarded based on: (1) The degree to which each partner, including all required partners, plays a committed role, either financial or nonfinancial, in the proposed project; (2) the breadth and depth of each partners contribution, their knowledge and experience concerning grant activities, and their ability to impact the success of the project; and (3) evidence, including letters of commitment from required partners, that key partners have expressed a clear dedication to the project and understand their area of responsibility. Applications that do not have each of the four required entities represented in the partnership cannot receive full points for this factor.

As to the charter fees, SDWP feels that the provisions of Sections 118 (b) (7) and (9) of the Act are adequately met. As previously discussed with

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OIG, prior to releasing the first Request for Business Plans (RFBP), SDWP held a total of ten public hearings: five throughout the county of San Diego (at least one in each region), two in front of the then one-stop committee, two before the Private Industry Council, and the final hearing before the Consortium Policy Board. At no time during these hearings did a potential bidder raise the issue of paying either charter fees or cash matches. Indeed the only significant issue raised, and the one that we were told by potential bidders caused them to drop out, was the requirement that the lead partner could not also be the one-stop training provider, a firewall that we believed to be prudent. (It should be noted that the FY 2000 charter fees were $10,000 per center.)

While SDWP had fewer public hearings around the 2004 issuance of the Request for Business Plans (RFBP), once again there was no feedback that charter fees should not be charged. One bidder did raise a concern around the *amount* of the charter fee (on average roughly $35,000 per center). SDWP did hear from potential bidders that they weren't sure that they should go through the expense of bidding because they were aware that the current operators were going to re-bid, and that the current operators had all exceeded performance standards.

SDWP does want to emphasize that the RFBP was not a traditional Request for Proposal that would normally be issued for a service provider. SDWP was seeking organizations that could not only run a multi-million dollar enterprise, but could prove that they could also bring other partners – not subcontractors – to the table, in addition to the seventeen mandated by the Act, and provide a true business plan on how the scope of the one-stops could be expanded. SDWP felt, and still feels, that if a bidder could not leverage $10,000 in non-federal dollars from its partners it was/is unlikely that they would be successful. This approach seems in accordance with DOL's policy initiatives. Again, from the Community-Based Job Training Grant Solicitation for Proposals:

• *Partnership Management (8 Points):* Points for this factor will be awarded based on: (1) The evidence of a plan for interaction between partners at each stage of the project, from planning to execution; (2) the evidence that the capacity challenge to be addressed by the grant was identified in the context of the strategic partnership; (3) demonstrated ability of the lead partner to successfully manage partnerships; (4) the ability of the partnership to manage all aspects and stages of the project and to coordinate individual activities with the partnership as a whole; <u>(5) the robustness of the applicant's plan for sustaining the partnership beyond the funding period,</u> and (6) evidence that the partnership has the capacity to achieve the outcomes of the proposed project.

As SDWP program performance and the many times that our one-stop system has been used as a national benchmark proves, SDWP believes that, in fact, bidders were chosen who are innovative, effective, and cost efficient.

SDWP respectfully asks that OIG clarify what question the auditors asked of the prospective bidders who now claim that they chose not to bid because of charter fee issues. Were they asked an open-ended question, e.g., "Why did you choose not to bid?" or was the question unintentionally biased, e.g., "Were the charter fees the reason you chose not to bid?"

Finally, SDWP would like to note that because of the concerns raised by OIG, SDWP stopped levying charter fees and cash matches effective July 1, 2006, and will continue to do this until the issue is resolved. Therefore, as to Finding 2a, Recommendation 13, SDWP respectfully requests that since it is no longer requiring charter fees and cash matches, that OIG consider the finding resolved. However, as with Recommendation 8, SDWP has raised this serious policy issue in a separate letter to the Assistant Secretary of the Employment Training Administration requesting a policy interpretation on the allowability of charging charter fees and encouraging cash matches from non-federal sources outside of the procurement process

Finding 2b.
SDWP did not adequately encourage the use of small businesses, minority-owned firms, or women's business enterprises.

SDWP Response
Previously, although SDWP did not have a formal procedure for identifying small-business, minority-owned firms, and women's business enterprises, SDWP disseminated information about its procurements to the widest possible audience through a number of other steps and feels that it complied with the spirit of the law. These other steps included the gathering of business and other potential service provider and vendor addresses for its mailing lists from various business and social service directories. A review of the mailing lists will show that small businesses, minority-owned and women's business are included.

In addition, to reach out to all possible potential bidders, a legal public notice providing complete details on each procurement was published in newspapers of general circulation, and our website, www.sandiegoatwork.com. Bidders' conferences were generally held and the Q&As of potential bidders were published on the website for all to read, as well as mailed to all known potential bidders. From time to time community meetings have been conducted, either at the design stage or the RFP stage, to assure that targeted organizations are fully informed. The timelines for all procurements are set to give even the smallest of potential bidders sufficient time to prepare a competitive and complete bid.

SDWP has revised its procurement guidelines in accordance with OMB Circular A-122 and implemented the specific steps to identify small business, minority-owned firms, and women's business enterprises, and utilize their services to the greatest extent possible, whether as a prime or subcontractor. See SDWP Exhibit J for a copy of the revised internal procurement guidelines.

OIG Recommendation:

14. Require SDWP to update procedures to comply with OMB Circular A-110's requirements for small business, minority-owned firms, and women's business enterprises.

SDWP Response to OIG Recommendation:

14. As to Recommendation 14, SDWP has revised its procurement guidelines in accordance with OMB Circular A-110 and will ensure that the revised guidelines are implemented by December 31, 2006. SDWP will ensure that steps are taken to identify small business, minority-owned firms, and women's business enterprises, and utilize their services to the greatest extent possible, whether as a prime or subcontractor. SDWP would respectfully request that this finding be considered resolved.

Finding 2c.
SDWP did not perform price or cost analyses for contracts awarded.

SDWP Response
SDWP's procurement process includes price analysis in the evaluation of proposals, but the files have been stored in separate locations (not in the procurement files). SDWP's procurement files do contain a detailed budget analysis but lack complete documentation of the cost or price analysis. However, SDWP acknowledges the need to upgrade procedures to ensure that a price or cost analysis is performed and that the findings of such analysis are fully documented.

OIG Recommendation:

15. Require SDWP to establish procedures to perform and document a cost and price analysis for each procurement.

SDWP Response to OIG Recommendation:

15. As to Recommendation 15, SDWP has already revised its internal procurement guidelines (see SDWP Exhibit J for the updated procurement guidelines) so that better documentation is maintained through the procurement cycle, and that documentation clearly demonstrates that the costs of what was procured were "reasonable, allowable, and allocable," per OMB Circular A-110 or that the price reflects best value. SDWP staff will be informed of the new procurement guidelines through in-house training seminars, to ensure that throughout the organization there is clear

and uniform understanding of the expectations of the procurement process. SDWP respectfully requests that this finding be considered resolved.

Finding 2d.
Equipment records did not contain all information required by OMB Circular A-122. Additionally, SDWP did not document their physical inventory of equipment or reconcile results to equipment records.

SDWP Response
During its site visit, OIG was unable to locate two Toshiba copiers. The two Toshiba copiers were purchased 12 years ago and were disposed of when they stopped functioning. Full depreciation on these copiers was reached in approximately the year 2000. Therefore, SDWP believes that no money is owed to DOL.

SDWP concurs with OIG's statement that it did not document its physical inventory of equipment or reconcile results to equipment records. This occurred in part because SDWP was keeping as inventory all items purchased for more than $100. This low threshold led SDWP to have over 11,000 items in its inventory system.

SDWP requested and received approval from the State of California to adjust its inventory list so that only items purchased for $5000 or more are tracked (see SDWP Exhibit K for correspondence between SDWP and EDD). Since receiving this approval, SDWP has conducted an inventory (see SDWP Exhibit L for a revised inventory listing) and reconciliation.

OIG Recommendations:

16. Require SDWP to update its equipment records to include all the information required by OMB Circular A-110.

17. Perform and document an equipment inventory every 2 years and reconcile the inventory to equipment records.

SDWP Response to OIG Recommendations:

16. As to Recommendation 16, SDWP has updated its equipment records to include all the information as required by OMB Circular A-110.

17. As to Recommendation 17, SDWP will perform and document an equipment inventory every 2 years and reconcile the inventory to equipment records.

SDWP respectfully requests that OIG consider Finding 2d to be resolved.

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