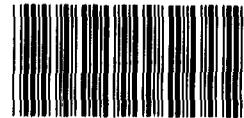


GAO

May 1990

JOB TRAINING PARTNERSHIP ACT

Review of Audit Findings Related to the Downriver Community Conference Program



142902

Detroit Regional Office

B-234733

May 16, 1990

The Honorable Carl Levin
United States SenateThe Honorable Donald Riegle
United States SenateThe Honorable John D. Dingell
House of RepresentativesThe Honorable William D. Ford
House of Representatives

Your March 15, 1989, letter asked us to review four expenditures by the Downriver Community Conference¹ under the Job Training Partnership Act (JTPA). The expenditures were:

- \$151,824 for contractual services to create a data base to be used to identify potential program participants,
- \$47,740 for a sole-source contract with a computer consultant,
- \$100,226 for the purchase of an air-conditioning system, and
- a \$4,725 payment to a terminated employee.

These expenditures were questioned in an independent audit report on Downriver activities for the 2-year period that ended September 30, 1987. You also asked us to review the appropriateness of the Michigan Department of Labor's resolution of the audit findings.

We determined whether each expenditure represented an allowable use of JTPA funds. We also determined the sequence of events related to each expenditure through discussions with current and former Downriver officials, and its landlord and contractors and through a review of project records. In addition, we reviewed applicable federal and state laws, and rules and regulations, and discussed the results of our analysis with state officials and regional and federal Department of Labor officials.

Our work was performed between February 1, 1989, and January 31, 1990, and was conducted in accordance with generally accepted government auditing standards.

¹A regional organization that, among other activities, provides employment training assistance to residents in the area funded, in part, by the Job Training Partnership Act.

Background

In program years 1985 and 1986, Michigan received \$156 million and \$136 million, respectively, under the JTPA program. To ensure that the funds are used appropriately and that applicable JTPA regulations and state rules are followed, Michigan regulations require that each local project be independently audited. When auditors question the allowability of costs incurred by a local project, state audit resolution officials are responsible for determining whether a violation of state rules has occurred requiring the repayment of JTPA funds.²

To comply with state audit requirements, Downriver had an independent audit performed, covering its activities over the 2-year period ending September 1987. The audit report reviewed \$12 million in JTPA funds received by Downriver for this period.

Results in Brief

We agree with the auditor and the state that, at the time of the audit, the costs for purchase of a data base to be used to identify potential program participants should have been disallowed.³ Information on persons who might be potential program applicants, to be provided under contract, was not requested or obtained by the Downriver project. However, after the state's determination to disallow this expenditure, Downriver requested the information (in the form of several reports), and the contractor expressed willingness to deliver it. If Downriver receives the reports, it may request the state to reevaluate the allowability of the expenditure. (See p. 8.)

Although the state allowed all costs for payments to a consultant for computer services, the costs incurred before the award of a contract under a competitive bid process should have been disallowed because the state had denied Downriver's original request for a sole-source contract, and instead required Downriver to have the contract competitively bid. (See p. 10.)

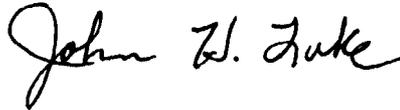
The expenditures for the air-conditioning system and payment to the terminated employee were allowed by the state. The expenditure for air-conditioning, however, was charged as rent rather than as a capital expenditure that requires state approval. The payment to the terminated employee was charged as severance pay but should have been charged as a settlement expense because it was made in return for the

²For a detailed explanation of the applicable legal requirements, see appendix I.

³A more detailed discussion of each of the questioned expenditures and the basis for our conclusions appear in appendix II.

employee's resignation and pledge not to file suit against Downriver for his termination. Neither federal nor state rules or regulations provide guidance on granting settlements. In the absence of such guidance, the state is responsible for determining the allowability of this expenditure. However, such a determination had not been made as of April 1990. (See p. 11.)

As you requested, we did not obtain written agency comments on this report. We did, however, discuss its contents with Michigan Department of Labor officials and Downriver management officials, incorporating their comments where appropriate. And, as agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time we will send copies of this report to the Secretary of Labor, the Michigan Department of Labor, and other interested parties. Should you have any questions, please call me on (313) 226-6044. Major contributors to this report are listed in appendix III.



John H. Luke
Regional Manager

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Abbreviations

GAO	General Accounting Office
JTPA	Job Training Partnership Act
OMB	Office of Management and Budget
PIC	Private Industry Council
RFP	request for proposals

Discussion of Applicable Legal Requirements

The Job Training Partnership Act (JTPA) (29 U.S.C. 1501 (1982)) authorizes federal financial support to states (and areas within states called service delivery areas) for various employment training programs. JTPA authorizes the U.S. Department of Labor, the agency charged with monitoring compliance with the act, to “prescribe such rules and regulations . . . as the Secretary deems necessary” (29 U.S.C. 1579(a)). The regulations Labor issued pursuant to this authority include standards for determining the allowability of state and local costs under JTPA. The cost allowability standards applicable at the times with which we are here concerned provide, among other things, that a cost must be “necessary and reasonable for proper and efficient administration of the program, be allocable thereto . . . , [and] not be a general expense” of the program (20 C.F.R. 629.37(a)(1986)). The regulations also provide that JTPA grant recipients must “administer procurement systems that reflect applicable State and local law, rules and regulations as determined by the Governor” (20 C.F.R. 629.34).

The Downriver Community Conference, acting as subgrantee, administers programs funded under the act in a service delivery area in the vicinity of Detroit. Approximately 75 percent of employment and training programs conducted by Downriver are funded under JTPA.

As required by Labor regulations (at 20 C.F.R. 627.1), the State of Michigan explicitly agreed in the grant agreement (Governor/Secretary Agreement) to comply with JTPA and applicable rules and regulations. The State of Michigan, which was delegated fiscal control over “disbursement of and accounting for” JTPA funds under section 164 of the act, also is responsible for reviewing grantees’ expenditures to determine whether they comply with Labor standards.

Additionally, the state has issued more detailed JTPA program administration instructions. These instructions, and not Office of Management

Appendix I
Discussion of Applicable Legal Requirements

and Budget (OMB) guidelines generally applicable to federal grant recipients, apply to the JTPA program expenditures discussed below.¹

¹In a preamble to the federal JTPA regulations, Labor stated, as follows: "... except for the few specific standards included in the regulations, 'the detailed administrative requirements of OMB Circulars A-87 and A-102 and implementing regulations in 41 C.F.R. Part 29-70 do not apply to JTPA programs administered by the Governors and their subrecipients.'" (48 Fed. Reg. 11076 (Mar. 15, 1983); 20 C.F.R. 628-684).

Labor implementing regulations also provide that state programs "operated under Titles I, II and III of the Act are not subject to the provisions of 41 C.F.R. Part 29-70, except as otherwise explicitly provided in this chapter" (20 C.F.R. 629.1(e)).

JTPA funds that were spent on the air conditioner at Downriver facilities, and on other costs examined in this memorandum, were derived entirely from programs established under titles I, II, and III of JTPA, which are programs generally administered by states and service delivery areas (20 C.F.R. Part 629). Therefore, cost allowability standards contained in OMB Circulars A-87 and A-102, and implementing regulations, were not applicable to JTPA funds applied by Downriver to the air conditioner or to the other expenditures discussed below.

Discussion of the Allowability of Costs for the Downriver Community Conference's Questioned Expenditures

The relevant facts pertaining to each of the four expenditures questioned by the auditor are summarized below together with GAO's conclusions and basis for those conclusions. As part of our discussion of the purchase of a data base for outreach, we also discuss the circumstances and our conclusion regarding a contract for a needs assessment and labor market survey performed by the same contractor.

Purchase of Data Base to Identify Potential Program Participants

During the spring of 1986, Downriver management agreed to pay a subcontractor \$151,824 to create a data base from 96,091 job applications to a local automotive manufacturer in return for access to the information from the data base. The information was to be in the form of seven computerized reports, listing the names and addresses and certain other characteristics of the persons that had applied for jobs at the automotive plant. The subcontractor created the data base. According to a Downriver official, the project planned to use the listings to identify potential JTPA program applicants. Downriver's intent was to use the data base to contact persons who were not hired by the plant and enroll in training those who were interested and qualified for the JTPA program. At the time of the audit, however, the information to be provided under the contract had not been requested or obtained by the Downriver project.

The auditor questioned the allowability of costs related to the contract because Downriver officials had not obtained the information for which they had contracted. He determined that to be an allowable cost, the JTPA program must derive some benefit from it, and, because the information was not obtained, no benefit was derived from the expenditure.

State officials concluded in their final determination letter that activities under this contract would have been allowable if Downriver officials had obtained the information under contract. However, because Downriver did not obtain the information to be provided under the contract, the state agreed with the auditor that JTPA had not benefited from the contract and that the \$151,824 spent under the contract should be disallowed.

GAO Conclusion

After considering questions raised regarding this activity, we conclude that the expenditure was for an authorized activity—outreach to identify potential program participants—under JTPA. However, because Downriver officials had not requested or obtained the information for which they contracted, we initially agreed with the auditor and the state

that the expenditure should be disallowed. But, on November 6, 1989, more than a year after the state's determination that the expenditure should be disallowed, Downriver officials requested that the contractor provide them with the information required under this contract, and the contractor has expressed willingness to deliver the reports. However, as of May 14, 1990, Downriver had not received the information. If Downriver receives the information, it may request the state to reevaluate whether the expenditure is allowable. The delay in the receipt of the information, however, may have reduced the benefit of the information to the JTPA program.

Needs Assessment and Labor Market Survey

Before awarding the contract for developing the data base to be used to identify potential program participants, Downriver officials in 1986 paid \$32,000 to have the same contractor complete a needs assessment and labor market survey. The purpose was to provide the project with information concerning the nature and availability of employment opportunities and training programs in the Downriver area. The contractor made a presentation to the Downriver Private Industry Council (PIC)¹ and staff summarizing the results of the survey. According to documents in Downriver's files, the information obtained from the contract was to be used to develop Downriver's JTPA plan. There was some question as to conflict of interest on the part of the contractor, who was a member of the PIC when the contract was entered into. Further questions were raised regarding whether funds paid by Downriver under this contract were used by the contractor to prepare for the subsequent contract to create the data base to be used to identify potential program participants.

GAO Conclusion

In reviewing the procedures used to award this contract, we found that federal, state, and local laws and regulations were not violated. Because the contractor did not participate in a PIC vote on the contract, JTPA was not violated. The state conflict of interest statute also was not violated because the contract in which the contractor had an interest was with Downriver, not with the PIC. Further, Downriver's bylaws were not violated because the contractor did not attend any meeting at which the contract was approved.

¹Established by JTPA, PICs consist of local business leaders, representatives of educational agencies, organized labor, rehabilitative agencies, community-based organizations, economic development agencies, and the local public employment service to provide overall policy guidance and oversight to the local JTPA program.

Although some work related to the data entry contract was performed before award of the outreach contract, there is no indication that funds received under the needs assessment contract supported this work. Further, the work appeared to be minimal when compared with the cost of the contract and would not have been significant enough to provide the contractor an unfair advantage in the award of the outreach contract.

Sole-Source Purchase of Computer Services

Downriver management entered into a sole-source contract with a computer consultant in December 1985, agreeing to pay \$30,240 for consulting services to improve the project's computer system. Because this was a sole-source contract that exceeded \$10,000, state approval of the contract was required. However, Downriver allowed the consultant to begin work before requesting state approval with the stipulation that the consultant would not be paid more than \$10,000 unless approval was granted.

State officials denied the sole-source request because they believed that other contractors were interested in bidding on the contract and were capable of delivering the required services. Although state officials denied the request, the consultant continued to work and was told by Downriver officials that he may bill them for services up to the \$10,000 limit for sole-source contracts.

After the state's denial of the sole-source request, local officials initiated a competitive bid process for the remaining work. According to Downriver management, the consultant was told to suspend all work that would be carried over to the competitive bid contract. After a request for proposals (RFP) was initiated, seven bidders received copies of the RFP and two proposals were submitted—one of which was from the sole source-consultant. The Downriver staff judged the sole-source consultant's proposal superior because of its extensive detail and substantially lower cost. The sole-source consultant's estimated cost for the remaining work was between \$20,000 and \$25,000, while the other bidder's estimated cost was \$63,000.

The auditor questioned whether payments made by Downriver under the sole-source contract were allowable because state officials had denied approval of the sole-source procurement.

State officials ruled that the costs under these contracts—the sole-source and the competitive bid—were allowable. They believed (1) the contractor could continue working after sole-source approval was

denied as long as the amount paid did not exceed \$10,000, and (2) an open and free competitive bid process followed. State officials determined that the Downriver board had not approved the contract as required by Downriver's procurement procedures, but concluded that this was not a violation of state JTPA rules and, therefore, was not a basis for disallowing the costs of the contract.

GAO Conclusion

Our analysis of this contract showed that local officials did not follow the contracting procedures established by state or local rules. We conclude, because the state denied Downriver's sole-source request, that all expenditures made for services performed before award of the competitively bid contract should be disallowed.

Our analysis of the competitively bid portion of the contract showed that it met the requirements of a free and open process. Another bidder participated in the process, but the sole-source contractor's proposal had the highest score and the lowest cost. Although the contractor did some prior work that could have given him an advantage, any competitive advantage did not result from preference by Downriver and, in any event, would have had no effect on the award. Thus, we conclude that this portion of contract costs should have been allowed.

Purchase of Air-Conditioning System

In February 1984, the Downriver board approved increasing rent payments to its landlord for the purchase and installation of a central air conditioner. For 17 months (Mar. 1984 through July 1985) the landlord kept the amounts designated for the air-conditioning system in an escrow account. In September 1985, a central air-conditioning system was installed in the Downriver building. After all costs had been paid, the landlord refunded to Downriver \$14,296 received in excess of the cost of the air conditioner. While payments to the landlord for the air conditioner totaled \$114,522, only \$71,986 was paid out of JTPA program funds. The remaining cost was paid from other Downriver programs that benefitted from the air-conditioning system.

The auditor questioned whether the cost of the central air-conditioning system was allowable because he believed it was a capital expenditure and local officials had not obtained state approval as required by state policy. State audit resolution officials disagreed with the auditor's conclusion and allowed Downriver to charge the air conditioner cost as rent, which is an allowable expense not requiring prior state approval.

GAO Conclusion

We believe the expenditure for the acquisition of the air conditioner was not rent, but was a capital expenditure because (1) the payments to the landlord were increased specifically for its purchase, (2) the landlord held the funds in an escrow account, which was used only to pay for the purchase and installation of the air conditioner, and (3) the landlord refunded the excess moneys.

Because Downriver did not follow the proper acquisition procedures, state officials did not rule on the allowability of this capital expenditure, as required under state rules. However, state officials told us that the purchase of an air-conditioning system can be an allowable capital improvement expense.

**Payment to a
Terminated Employee**

On October 10, 1986, Downriver paid the manager of its fiscal department \$4,725 in return for his resignation and pledge not to sue Downriver. According to Downriver officials, they had suggested the employee look for work elsewhere. Downriver management were concerned about firing him, however, because they feared he might file a lawsuit against the project. The payment represented approximately 2 months of the employee's salary and was characterized as severance pay by Downriver officials.

The auditor questioned the allowability of severance pay because Downriver personnel policy prohibited such payments. State officials, however, disagreed with the auditor and found the costs were allowable. They cited a rule in the Downriver policy that authorized Downriver management to make unilateral changes to policy.

GAO Conclusion

The rule in the personnel manual cited by state officials allows Downriver management to change personnel policy without approval from an employee committee. This rule does not, however, authorize Downriver to deviate from established policy. Downriver management was not authorized to make an exception to its personnel policy in order to provide severance pay to one employee.

We believe that Downriver's characterization of the payment as severance was incorrect. The payment was made in return for the employee's resignation and pledge not to sue Downriver. Therefore, we believe the payment would be more correctly characterized as a settlement.

Appendix II
Discussion of the Allowability of Costs for
the Downriver Community Conference's
Questioned Expenditures

Because the payment was incorrectly characterized, state officials did not review the payment as a settlement to determine its allowability. We found that neither federal nor state rules or regulations provide guidance on granting settlements in JTPA programs. In the absence of specific cost allowability guidance, the state is responsible for determining the allowability of expenditures.

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