OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

FINANCIAL ASSISTANCE AUDIT

Cooperative Agreement No. JSA071001/L08AC13913 Between the Utah Correctional Industries and the Bureau of Land Management

Report No.: WR-CA-BLM-0013-2013 September 2013

OFFICE OF
INSPECTOR GENERAL
U.S.DEPARTMENT OF THE INTERIOR

September 27, 2013

Memorandum

To: Maria Gochis
Grants Management Officer, Utah State Office
Bureau of Land Management

From: Michael P. Colombo
Western Regional Manager for Audits, Inspections, and Evaluations

Subject: Final Audit Report – Cooperative Agreement No. JSA071001/L08AC13913 between the Utah Correctional Industries and the Bureau of Land Management
Report No. WR-CA-BLM-0013-2013

This report presents the results of our audit of reported costs submitted by the State of Utah, Department of Corrections, Correctional Industries Division (Utah Correctional Industries, or UCI) under cooperative agreement number JSA071001/L08AC13913 with the Bureau of Land Management (BLM). UCI reported total expenditures of $5,338,880 on its final Federal Financial Report (SF 425). We identified questioned costs of $1,076,464 and unsupported costs of $928,089. The "Results of Audit" section of this report provides details on these costs.

Background

UCI is a division of the State of Utah's Department of Corrections and offers products and services to State agencies, local governments, and institutions of higher learning. As part of its mission to train inmates in realistic work environments to gain the skills needed to return to a productive life in society, UCI employs inmate labor to provide its products and services. UCI offers products such as office furniture, clothing, and mattresses, as well as labor-intensive services such as general construction, roofing, and pavement crack sealing. UCI is completely self-supported and derives its revenues solely from the sales of its products and services.

On March 19, 2007, BLM entered into a cooperative agreement with UCI for a horse-gentling program. According to the cooperative agreement, the horse-gentling program would further BLM's Wild Horse and Burro Program by increasing the number of horses available for adoption by the public. In return, the horse-gentling program would provide inmates with work opportunities and rehabilitation through caring for, feeding, training, and gentling wild horses. Under the cooperative agreement, UCI would establish the program at the Central Utah Correctional Facility in Gunnison, UT, and BLM would house its wild horses there under the Wild Horse and Burro Program.

According to the cooperative agreement, 30 to 50 horses would be trained annually. The horse-gentling program started in April 2007 with 99 horses. The number of horses held at the

UCI facility increased rapidly, to about 1,500 in September 2012. Most of these horses were not being trained, but were being stabled at the facility on a short-term basis.

The cooperative agreement was amended a number of times to extend the performance period and add to program funding. The performance period of the agreement ran from March 19, 2007, to September 30, 2012, and the total amount of Federal funding committed by BLM was $5,338,880. In addition, UCI agreed to fund $154,714. UCI agreed to provide facilities at Gunnison that conformed to BLM guidelines and specifications at no cost to BLM. At the time of our audit, UCI was continuing to operate the program under a follow-on cooperative agreement with BLM.

BLM's cooperative agreement provided that BLM would reimburse UCI for each horse held at UCI's facility at a rate of $2.75 per head per day. BLM and UCI jointly agreed to increase the reimbursement rate three times during the performance period, with the last rate in effect being $3.55. The agreement also provided that BLM would reimburse the actual costs incurred for veterinarian services and supplies as well as costs for euthanizing and removal of suffering animals.

The cooperative agreement specifically referenced the Code of Federal Regulations (C.F.R.) for cost sharing and program income and stated that the award to UCI was subject to the terms and conditions incorporated by reference in the C.F.R., including the administrative and audit requirements and cost principles for assistance programs (43 C.F.R. § 12(C)).

Objectives

The objectives of our audit were to determine whether reported costs were—

- allowable under applicable Federal laws and regulations;
- allocable to the cooperative agreement and incurred in accordance with its terms and conditions; and
- reasonable and supported by the recipient's records.

To meet the objectives of the audit, we—

- interviewed the grants management officer, the UCI division director, and other appropriate individuals;
- obtained information from UCI on the number of horses held at the Gunnison facility over the life of the agreement;
- reviewed cost sharing and program income under the agreement;
- reviewed the cooperative agreement and the C.F.R. for criteria pertaining to the horse-gentling program; and
- reviewed support for reported costs provided by UCI.

Scope

Our audit work included reviewing UCI's reported costs from March 19, 2007, to September 30, 2012, totaling $5,338,880 following two approaches. First, we obtained information from UCI on the number of horses held at the Gunnison facility over the life of the agreement, and determined the amount reimbursable to UCI based on the rates contained in the cooperative agreement. Second, we obtained UCI financial statements and reports from their accounting system to determine allowable costs as defined by 43 C.F.R. §12.62.

Methodology

We conducted this audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We performed our audit without the benefit of a technical evaluation. Accordingly, our opinions and conclusions are qualified to the extent that a technical evaluation may affect the allowability and reasonableness of the proposed costs. Our conclusions on questioned and unsupported costs are discussed in the "Results of Audit" section of this report.

Results of Audit

We based our determination of questioned and unsupported costs on our review and evaluation of UCI's reported costs. We questioned costs that were not allowable under terms of the agreement and applicable provisions of the C.F.R. In addition, we identified costs as unsupported when sufficient documentation related to the costs was not available for review. Of the $5,338,880 reported by UCI, we questioned $1,076,464 and classified $928,089 as unsupported. The results of our review are summarized in the table below.

Questioned and Unsupported Costs under Cooperative Agreement Number JSA071001/L08AC13913

Description	Recorded Costs (Note 1)	Questioned Costs	Unsupported Costs	Difference (Note 2)	Notes
Direct labor	$1,019,896			$1,019,896	
Contractual services	23,077		$23,077		3
Equipment rental	10,593		959	9,634	4
Motor pool vehicles	52,477			52,477	
Building and grounds	125,588	$125,588			5
Equipment	27,976			27,976	
Hay purchases	2,174,788		137,691	2,037,097	6
Shop supplies	18,526			18,526	
Inmate labor	103,531			103,531	
Depreciation	19,539	8,298		11,241	7
Other direct costs	14,255		1,430	12,825	8
Total direct costs	$3,590,246	$133,886	$163,157	$3,293,203	
Indirect costs	806,056		764,932	41,124	9
Total direct and indirect costs	$4,396,302	$133,886	$928,089	$3,334,327	
Net reimbursable costs less than agreement amount	39,683	39,683			10
Recorded costs less than reimbursable costs per terms of cooperative agreement	902,895	902,895			11
Total	$5,338,880	$1,076,464	$928,089	$3,334,327	

Notes

1. Recorded Costs

The direct costs shown in this column are from UCI's monthly accounting system expense reports that it recorded for the horse-gentling program. We included in the "hay purchases" cost the amount recorded in UCI's asset account because UCI's recorded hay expenses represented only the amount of hay used. The indirect costs are from the monthly profit and loss statements prepared by UCI for the horse-gentling program.

The $5,338,880 total of this column represents the expenditures that UCI reported under the cooperative agreement on its final Federal Financial Report. A UCI official told us that the amount reported was based on the total amount funded by BLM and that UCI did not bill BLM based on recorded costs. UCI was unable to provide any documentation to support the composition of the expenditures it reported. BLM's grants management officer provided us with documents confirming that this was the amount that BLM paid UCI under the agreement.

The differences between the total direct and indirect costs and the reported expenditures are discussed further in the cited notes.

2. Difference

We presented the amounts in this column solely for BLM's convenience. They are not audit-approved or recommended amounts. Our office does not approve or recommend these costs because those amounts depend partly on factors outside the realm of accounting expertise, such as opinions on technical matters.

3. Contractual Services

UCI did not provide documentation to support the $23,077 in costs recorded under the contractual services account. This amount consisted of a fiscal year 2012 journal entry to move costs of building corrals to expense. We therefore classified the $23,077 as unsupported.

4. Equipment Rental

UCI did not provide documentation to support two transactions recorded under the equipment rental account. The amounts of the transactions from fiscal year 2011 were $459 and $500. We therefore classified $959 of equipment rental costs as unsupported.

5. Building and Grounds

Section III.A.6 of the cooperative agreement states: "[T]he recipient agrees to provide facilities that conform to BLM guidelines and specifications at no cost to the BLM." Based on this language and the provision that UCI would fund a share of the program costs itself, we questioned the $125,588 of recorded building and grounds costs.

6. Hay Purchases

UCI's monthly accounting system expense reports show a net $2,037,097 of expenses for hay used during the period of the cooperative agreement. UCI officials and the grants management officer told us, however, that under the current follow-on cooperative agreement, BLM is reimbursing UCI for the cost of the hay purchased rather than the hay used. UCI reported in its financial statements $137,691 of hay in inventory as of June 30, 2012, the end of the State of Utah's fiscal year.[1] According to 2 C.F.R. § 225 (Office of Management and Budget Circular A-87), direct costs chargeable to Federal awards can include the cost of materials acquired, consumed, or expended specifically for the purpose of those awards. We therefore added these two amounts to arrive at recorded

[1] UCI did not provide us with its asset account balance as of September 30, 2012.

hay purchase expenses of $2,174,788 and classified the $137,691 as unsupported because we could not determine the disposition of UCI's hay inventory.

7. Depreciation

Included in the depreciation expense account for the horse-gentling program was $8,298 of depreciation relating to the horse building. We questioned this cost because the cooperative agreement stated that UCI would provide the facilities at no cost to BLM.

8. Other Direct Costs

We combined the expenses from 23 expense accounts that had totals of less than $10,000 over the period of the cooperative agreement. From our sample of expenses recorded in these accounts, UCI did not provide us documentation to support four transactions as shown in the table below. We therefore classified $1,430 of other direct costs as unsupported.

Other Unsupported Direct Costs

Account	Fiscal Year	Amount
Advertising and legal publications	2007	$546
Repairs to damaged vehicles	2008	225
Repairs to damaged vehicles	2011	159
Regulate fees license permits	2008	500
Total		$1,430

9. Indirect Costs

UCI's monthly profit and loss statements show $806,056 of indirect costs for the horse-gentling program. UCI allocated these costs on the profit and loss statements based on the revenues of each of the UCI programs. Appendix E to 2 C.F.R. § 225 provides that State government units desiring to claim indirect costs under assistance agreements must prepare indirect cost rate proposals for submission to their cognizant Federal agencies. UCI did not have indirect cost rates approved for most of the agreement's performance period. On July 15, 2013, however, the Interior Business Center approved a provisional indirect cost rate of 67.51 percent of total direct costs, less capital expenditures, passthrough funds, and horse feed (hay), for the period July 1, 2012, through June 30, 2013. Based on the recorded direct costs for July 1 to September 30, 2012, we computed allowable indirect costs of $41,124 as shown in the following table.

Allowable Indirect Costs for July 1, 2012 – September 30, 2012

Description	Amount
Direct labor	$54,459
Motor pool vehicles	821
Buildings and grounds	164
Other direct costs	1,278
Hay purchases	38,286
Inmate labor	4,358
Depreciation	2,126
Total direct costs	$101,492
Less hay purchases	38,286
Less capital expenditures	
Buildings and grounds	164
Depreciation	2,126
Adjusted direct costs	$60,916
Indirect cost rate	67.51%
Allowable indirect costs	$41,124

In the absence of approved indirect cost rates for the balance of the agreement's performance period, we classified the remaining $764,932 of indirect costs as unsupported.

10. Net Reimbursable Costs Less Than Agreement Amount

Using the reimbursement provisions provided for in the cooperative agreement, we computed a reimbursable amount of $5,317,888. This computation is based on applying the daily rates identified in the cooperative agreement to the daily horse counts according to records provided by UCI. A UCI official told us that UCI did not incur any costs for veterinary services or euthanizing horses as BLM directly funded these types of costs.

UCI also received program income during the operation of the program. As this income was generated through horse adoptions, UCI should have reported it to BLM as required by the cooperative agreement, but it did not. Based on our review of UCI's revenue account for the horse-gentling program, we determined that UCI received $18,691 from horse adoptions that exceeded the base fees that were paid to BLM.

The cooperative agreement states that program income will be accounted for in accordance with 43 C.F.R. § 12.65. Subsection (g) of this C.F.R. provision states that program income will be deducted from total allowable costs to determine net allowable costs.

By deducting program income from reimbursable costs calculated in accordance with the language of the cooperative agreement, we computed net reimbursable costs of $5,299,197. We therefore questioned the $39,683 of reported costs that exceed the net reimbursable amount, as follows:

Costs that Exceed the Net Reimbursable Amount

Date	Horse Count	Rate/Day	Total
April 2007 to June 2008	180,165	2.75	$495,454
July 2008 to June 2011	911,966	3.05	2,781,496
July to September 2011	102,607	3.30	338,603
October 2011 to September 2012	479,531	3.55	1,702,335
Reimbursable costs			$5,317,888
Less program income			18,691
Net reimbursable costs			$5,299,197
Agreement amount			5,338,880
Difference questioned			$39,683

11. Recorded Costs Less Than Net Reimbursable Costs

UCI's accounting system showed direct horse-gentling program expenses totaling $3,452,555 for the period of the cooperative agreement. In addition to these expenses, UCI's financial statements show that UCI spent an additional $137,691 on hay that was paid for but not used at the end of the performance period. UCI's profit and loss statements showed $806,056 of indirect costs allocated to BLM's horse-gentling program. UCI's total direct and indirect costs for BLM's horse-gentling program therefore totaled $4,396,302. This amount is $902,895 less than the $5,299,197 of net reimbursable costs computed under the terms of the cooperative agreement. We classified the difference as questioned per 43 C.F.R. § 12.62 (a)(2), which states that any fee or profit of the recipient, or other increment above allowable costs, may not be funded with Federal assistance funds.

Other Issues

The cooperative agreement provides for reimbursement using specified rates instead of providing for cost reimbursement in accordance with 43 C.F.R. § 12.62. The results of our audit identified questioned costs of $39,683 based on the application of the rates identified in the cooperative agreement. Using the criteria contained in 43 C.F.R. § 12.62, we questioned an additional $1,036,781 and classified $928,089 as unsupported. The scope of our audit did not include reviewing legal issues pertaining to the apparently conflicting reimbursement provisions of the cooperative agreement. We therefore suggest that BLM work with the Solicitor's Office in reviewing and resolving the report's questioned and unsupported costs.

In addition, we found that UCI's accounting systems do not fully comply with the standards set forth in 43 C.F.R. § 12.60 for financial reporting, budget control, and allowable costs. UCI officials told us that the horse-gentling program is the first and only Federal assistance program UCI has had. Its financial statements and supporting accounting records are based on standards applicable to enterprise funds, which are akin to business operations and not typical governmental operations. We believe UCI did not adapt its accounting systems to the C.F.R.

standards because of confusion resulting from the agreement's reimbursement terms and directions given by the grants management officer. We suggest that in future cooperative agreements, BLM clearly delineate the financial management expectations and requirements of the C.F.R.

Response to Report

In accordance with the Departmental Manual (361 DM 1), please provide us with your written response to this report by December 30, 2013. Please include copies of documentation related to the final disposition of these costs in your response. If final disposition of these costs is not obtained by the requested date, please provide information on actions taken or planned, as well as target dates and title(s) of the official(s) responsible for implementation.

Please address your response to:

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The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, inspection, and evaluation reports issued, actions taken to implement our recommendations, and recommendations that have not been implemented. If you have any questions regarding this report, please call Thomas Kossow, team lead, at 916-978-5645, or me at 916-978-5653.

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