
Audit of Unemployment and Workers
Compensation Charges
by the Detroit Public Schools
Detroit, Michigan

FINAL AUDIT REPORT



Audit Control Number A05-90005
February 1999

Our mission is to promote the efficient
and effective use of taxpayer dollars
in support of American education



U.S. Department of Education
Office of Inspector General
Chicago, IL

NOTICE

Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by appropriate Department of Education officials. This report may be released to members of the press and general public under the Freedom of Information Act.

February 2, 1999

MEMORANDUM

TO: Gerald N. Tirozzi
Assistant Secretary
for Elementary and Secondary Education

FROM: Richard J. Dowd
Regional Inspector General
for Audit, Region V

SUBJECT: FINAL AUDIT REPORT
*Audit of Unemployment and Workers Compensation Charges
by the Detroit Public Schools, Detroit, Michigan*
ED Audit Control Number A05-90005

Attached is the final audit report of Detroit Public Schools' unemployment and workers compensation charges to Federal programs. In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the findings and recommendations in this report.

If you have any questions or wish to discuss the contents of this report, please contact me at 312-886-6503. Please refer to the above audit control number in all correspondence relating to this report.

Attachment

February 2, 1999

Dr. Eddie L. Green
General Superintendent of Schools
Detroit Public Schools
5057 Woodward Avenue
Detroit, MI 48202

Dear Dr. Green:

This *AUDIT REPORT* presents the results of our review of unemployment and workers compensation charges to Federal programs.

AUDIT RESULTS

The Detroit Public Schools [DPS] does not annually calculate the unemployment and workers compensation portion of its fringe benefit rate because it does not have a formal policy requiring the annual calculation. If DPS does not calculate a new rate annually, it could overcharge the Federal programs for unemployment and workers compensation costs.

Office of Management and Budget [OMB] Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, "Attachment A-General Principles for Determining Allowable Costs," defines a cost as reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In addition, when determining reasonableness, the cost principles state consideration should be given to the restraints or requirements imposed by such factors as sound business practices; arms length bargaining; Federal, State, and other laws and regulations; and terms and conditions of the Federal award.

Circular A-87, "Attachment B-Selected Items of Cost," defines fringe benefits as allowances and services provided in addition to regular salaries and wages. Workers compensation and unemployment costs are allowable and shall be allocated in a manner consistent with the pattern of benefits attributable to the individuals or groups of employees whose salaries and wages are chargeable to such Federal awards and other activities. In addition, fringe benefits are allowable to the extent that the benefits are reasonable.

We believe sound business practices dictate that reasonable costs should be estimated using historical experience and reasonable assumptions. When historical data show large fluctuations from year to year, a sound business practice would dictate annual calculations of the fringe benefit rates.

DPS last calculated new unemployment and workers compensation fringe benefit rates using 1994-95 award year data. An analysis of the unemployment costs disclosed large fluctuating costs ranging from a 183 percent increase in 1995-96 and a 9.89 percent increase in 1996-97 to a 58 percent decrease in 1997-98. In addition, an analysis of the workers compensation costs for 1995-96, 1996-97, and 1997-98 disclosed actual costs were 13 to 16 percent higher than the 1994-95 costs used to calculate the rate. As a result, DPS undercharged the Federal programs for unemployment and workers compensation costs during the three year period. During our on-site field work, DPS was recalculating its unemployment and workers compensation rates using the 1997-98 costs. If it did not recalculate new rates using the lower costs, DPS could overcharge Federal programs in the future.

In a written response to our finding point sheet, DPS agreed with the finding. It admits that the calculation of fringe benefits has not been done consistently during the past four years. However, it said DPS has developed a procedure for annually calculating the fringe benefit rate and a policy describing the methodology used for the calculation. DPS's comments are attached to the report.

Recommendation

We recommend that DPS implement the procedures it says it developed for annually calculating the fringe benefit rate used to charge Federal programs.

BACKGROUND

The U.S. Department of Education [ED], Office of Elementary and Secondary Education, administers the programs established by the Elementary and Secondary Education Act, as amended, and the Improving America's Schools Act. These programs provide financial assistance and opportunities for local and state education agencies and other institutions to support services for children to acquire the knowledge and skills contained in the state content standards and to meet the state performance standards developed for all children. ED provides funds to state education agencies to carry out their responsibilities with respect to local education agencies. DPS participated in 14 Federal programs and was awarded \$116,760,806 during the 1997-98 award year, 11 programs funded through the Michigan Department of Education, Michigan Job Commissions, and Wayne County Intermediate School District, and 3 programs funded directly by ED.

AUDIT SCOPE AND METHODOLOGY

The purpose of our audit was to determine if DPS charged Federally funded education programs an equitable share of unemployment and workers compensation insurance premiums. Our audit covered the period July 1, 1997 through June 30, 1998. However, we reviewed prior years' costs to determine if the rates used were equitable. We performed field work at:

- ◆ Arthur Andersen, CPA in Detroit, Michigan from October 19-20, 1998.
- ◆ PricewaterhouseCoopers, CPA in Detroit, Michigan from October 21-22, 1998.

- ◆ DPS in Detroit, Michigan from November 16-20, 1998 and November 30, 1998 through December 4, 1998.

To accomplish our purpose, we:

- ◆ Performed a preliminary review and assessment of management controls and accounting controls related to the administration of the unemployment and workers compensation programs.
- ◆ Reviewed and flowcharted policies and procedures for the unemployment and workers compensation process and personnel responsibilities.
- ◆ Reviewed and analyzed A-133 audit reports, management reports, and supporting working papers, fringe benefit rates, unemployment and workers compensation rate calculations, accounting records and spreadsheets, and State funding reports.
- ◆ Reviewed an organizational chart, newspaper clippings, Internet information, contracts with third party entities, DPS reports, and various unemployment and workers compensation forms.
- ◆ Interviewed 13 DPS officials and employees.
- ◆ Recalculated selected monthly fringe benefits charged to 14 Federally funded programs.

We conducted our audit in accordance with government auditing standards appropriate to the scope of review described above.

STATEMENT ON MANAGEMENT CONTROLS

As part of our audit, we made an assessment of DPS's management control structure, policies, procedures, and practices applicable to the scope of the audit. The purpose of our assessment was to determine the level of control risk; that is, the risk that material errors, irregularities, or illegal acts may occur. The control risk assessment was performed to assist us in determining the nature, extent, and timing of substantive tests needed to accomplish our audit purpose and objectives.

To make the assessment, we identified and classified the significant management controls into the following categories:

- ◆ Calculating fringe benefit rates
- ◆ Obtaining payroll data to allocate unemployment and workers compensation charges
- ◆ Calculating the charges
- ◆ Recording the charges

◆ Requesting Federal funds

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, our assessment disclosed a weakness specifically related to the area of annually calculating the unemployment and workers compensation fringe benefit rates. This weakness is discussed in the "AUDIT RESULTS" section of this report.

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on the audit:

Gerald N. Tirozzi, Assistant Secretary
U.S. Department of Education
Office of Elementary and Secondary Education
Federal Office Building 6, Suite 3W300
400 Maryland Avenue, S.W.
Washington, D.C. 20202-6100

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 35 days would be greatly appreciated.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and the general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

Richard J. Dowd
Regional Inspector General
for Audit - Region V

DETROIT PUBLIC SCHOOLS

William E. Aldridge
Chief Financial Officer/Associate Superintendent
DIVISION OF FINANCIAL SERVICES
5057 Woodward — Room 260
Detroit, Michigan 48202
(313) 494-1097
(313) 494-7832 (Fax)
January 12, 1999

Mr. Robert Swedberg
U.S. Department of Education
Office of Inspector General/Investigation
Region V
111 North Canal, Suite 940
Chicago, Illinois 60606

**RE: Unemployment Fringe Benefit Rates
Annually – Finding (See Enclosed)**

Dear Mr. Swedberg:

I am in agreement with your recommendation that the Detroit Public School District calculate an annual fringe benefit rate. I believe that during your investigation, you were made aware that a rate had been calculated for usage during the 1998-99 fiscal year. However, this calculation had not been done consistently within the past four years. After realizing this oversight, a procedure was developed resulting in the annual calculation of the fringe rate. Policies have been developed which determine the methodology to be utilized for the calculation.

If I can be of further assistance, please contact me.

Sincerely,



William E. Aldridge, C.P.A.
Associate Superintendent/Chief Financial Officer
Division of Financial Services
Detroit Public Schools

/ah

Enclosure

pc: Eddie L. Green, Ed.D, General Superintendent
Terrie L. Williams, Director, Office of Budget

EDDIE L. GREEN, Ed.D.
General Superintendent

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Action Official

Gerald N. Tirozzi

Assistant Secretary for Elementary and Secondary Education

Office of Elementary and Secondary Education

U. S. Department of Education 1

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David Frank, Office of Public Affairs 1

Secretary's Regional Representative, Region V 1

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