UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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HUMAN RESOURCES
DIVISION

B-195620

SEPTEMBER 18, 1980

The Honorable Ray Marshall
The Secretary of Labor

Dear Mr. Secretary:

Subject: The Employment And Training Administration Should Stop Using State Agencies To Pass Funds Through To Contractors (HRD-80-109)

Offices in Labor's Employment and Training Administration (ETA), by arranging for "pass through" agreements to obtain services for several of their activities, have effectively circumvented procurement and award administration safeguards designed to ensure that Federal moneys are properly and effectively spent and that agencies are accountable for their procurement actions. A pass through agreement is a procurement initiated and principally carried out by ETA, but entered into by a State and a contractor using Federal funds granted to the State. The results of the work have nationwide or regional application rather than primarily accruing to the State.

We discussed with Labor headquarters and region IX officials and with Nevada Employment Security Department officials the origin of and contractual responsibilities for nine pass through agreements in Nevada. In addition, ETA officials identified nine other possible pass through agreements (nationwide) for us. We limited our work to the Nevada agreements since at the time the agreements were identified for us the nine Nevada agreements comprised half the number of agreements and $2,161,737 (60 percent) of the $3,606,419 nationwide total. The Nevada agreements ranged from $14,840 to $1,350,000 and spanned several fiscal years. These nine agreements were scheduled to terminate prior to 1980, although one agreement is now handled through the State of Michigan and is scheduled to end in 1981.

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PURPOSE OF WORK PERFORMED

The work to be performed under the nine agreements varied, but all were to increase knowledge of or provide assistance to employment service, unemployment insurance, labor market information, or work incentive activities. The work was to be utilized primarily at the regional or national level, rather than primarily benefiting Nevada's activities. For example, at Labor's request Nevada's Employment Security Department signed agreements with:

--Basics Information Systems, Inc., an Alexandria, Virginia, firm, to process Job Openings Bank information submitted by States. This information is the basis for periodic and special reports on the extent and kinds of jobs available throughout the Nation.

--Evaluation Techniques Consortium, a Northridge, California, firm, to assess labor market information programs in State employment security agencies and recommend needed changes.

--The Orkand Corporation, a Silver Spring, Maryland, firm, to improve existing materials that provide an analytical approach to financial management for the Work Incentive program. A Labor official told us that the materials were distributed to Labor headquarters and its 10 regional offices, Nevada, and to other States.

--Management Engineers, Inc., a Reston, Virginia, firm, to assist Labor headquarters with analyzing data and generating reports on the Unemployment Insurance Services' appraisals of States' performance.

LABOR'S AND NEVADA'S CONTRACTUAL ROLES IN AGREEMENTS

Labor and Nevada officials told us that Labor selected the contractors to do the work, negotiated the substantive aspects of the agreements, asked Nevada to enter into the agreements with the contractors, monitored work progress, and certified invoices submitted by the contractors. Nevada's contractual role was limited to ensuring that the draft agreements were in proper form, obtaining State officials' and contractors' signatures, and paying bills from Labor-certified invoices. Nevada officials told us that they did not monitor

work progress to ensure contractual obligations were met; however, for several of the agreements Nevada officials told us that they kept apprised of the progress of the work because they were interested in it.

REASONS FOR PASS THROUGH AGREEMENTS

For six of the agreements, Labor officials told us that they used the pass through arrangement because there were insufficient funds, which they could obligate directly, available to spend for the work. Instead, they used funds available under the Grants to States for Unemployment Insurance and Employment Services appropriation. According to Labor officials, under law these funds must be granted to States; Labor cannot obligate these funds directly to contractors for activities, such as those discussed in this report. Therefore, Labor used these funds by using the pass through arrangement. For the seventh project using Grants to States funds, a Labor official told us that the pass through arrangement was used because they lacked staff to go through a formal procurement process and that sufficient funds which could be directly obligated for the work were probably not available.

One project was funded with Work Incentive funds which Labor could have used to contract directly for the work. Labor officials told us that they used the pass through arrangement because they lacked the time to go through a formal procurement process. The remaining project used Comprehensive Employment and Training Act (CETA) funds, which Labor also could have used to contract directly for the work. We could not obtain the reason for using the pass through arrangement because the key Labor official had retired.

Labor officials felt that the pass through contracting method was justified because the work benefited the employment security system rather than merely affecting Federal operations. They felt that the work was needed and that results from the pass through agreements improved the employment security system. One Labor official told us that accountability for expenditures was present because Labor officials monitor the work and assure themselves that work has been done before invoices are forwarded to Nevada for payment.

Nevada officials told us that they agreed to act as paying agent for the agreements to cooperate with Labor in the Federal-State employment security partnership. They also told us that while the work does not primarily benefit Nevada activities, Nevada benefits by being aware of the progress of the work and results earlier than others. Thus, they will be in a good position to take advantage of the results, if appropriate.

A Labor official told us that as of July 1980 pass through agreements are being used minimally. He stated that as a result of our inquiries regarding pass through agreements Labor officials are being informally advised to use other methods to accomplish the work.

PASS THROUGHS BYPASS PROCUREMENT SAFEGUARDS

Although we do not question the legal basis for these awards, we believe that Labor should procure these services, when needed, directly. Labor is much more heavily involved than Nevada in these pass through agreements. Although Labor initiates the work and performs the major portion of award administration, Labor is not a party to the agreements. Nevada signs the agreements, but does so only at Labor's request; and the work is not done to directly improve Nevada's employment security activities. Under these conditions it would seem logical that Labor should contract directly for the work.

Since Labor is not a party to these pass through agreements, the agreements are not subject to Federal procurement procedures, which are designed to protect the Federal Government's interests. Nevada's role is minimal--it obtains signatures on the agreements and pays bills from invoices certified by Labor--therefore, it cannot be counted on to protect the Government's interests. These conditions also argue for direct procurement by Labor.

AGENCY COMMENTS AND OUR EVALUATION

We asked the Department of Labor whether using grant moneys for pass through agreements was within the purpose for which the funds were appropriated. Labor's response (see encl. I) stated that the pass through method was an economical way to improve the management and operations at each of the State employment security agencies.

For the employment service projects funded from the grants to States appropriation, Labor stated that the pass through method appeared to be the sole available method for obtaining studies and conducting projects that are beneficial to the entire employment service system. Labor also stated that the alternative would be the inefficient and costly method of giving piece-meal grants to each State agency for studies and projects. We would also point out that the Department receives program administration appropriations which it can obligate directly and which could have been used for these studies and projects.

For the unemployment insurance projects, Labor stressed the benefits of these projects and stated that the Congress was well aware of the pass through method citing a brief passage from appropriation hearings in January 1962. Labor stated that no legislative restriction on such grant procedures was placed into the Social Security Act or appropriation acts as a result. First, we are not questioning the benefits of these activities but the methods used to procure them. Second, we believe the appropriate congressional committees should be made aware of the practices used to procure such activities on a current basis.

For the projects funded with CETA and work incentive funds (which Labor could have obligated directly instead of using the pass through arrangement) Labor stated that the efficiency of channeling funds through one State agency for the benefit of all is readily apparent. In our view, Labor's justification for using pass through agreements is not readily apparent. Since Labor could have been a party to the contract rather than using the pass through arrangement, it appears that expediency--and not efficiency--was the motivating factor.

CONCLUSIONS AND RECOMMENDATIONS

Labor's use of pass through agreements for achieving ETA goals does not ensure that the Federal Government's interests are protected. These agreements effectively circumvent the procurement standards and safeguards set forth to ensure effective use of Federal moneys. Accordingly, we recommend that the Secretary of Labor

--discontinue using State agencies to enter into agreements that pass through funds to contractors for work having regional or nationwide application; and

--where Labor has a continuing need to obtain the services for the kinds of activities discussed in this report, request sufficient funds from the Congress to allow Labor to procure these services directly.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after

the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the House and Senate authorizing and appropriations committees for the activities discussed in this report, Director, Office of Management and Budget, and other interested parties.

Sincerely yours,

Gregory J. Ahart
Director

Enclosure

ENCLOSURE I

U.S. DEPARTMENT OF LABOR
OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20210

MAR 4 1980

Henry R. Wray, Esq.
Assistant General Counsel
U. S. General Accounting Office
Washington, D. C. 20548

Your reference: B-195620

Dear Mr. Wray:

Your inquiry to the Secretary of Labor regarding several agreements with the Nevada Employment Security Department (NESD) has been referred to this office for a response.

You stated that eighteen so-called "pass-through" agreements were identified in a recent GAO audit of federal agreements with the State of Nevada. The funds for the grants in question derive from Federal employment service and unemployment insurance administrative sources, and from monies appropriated for work incentive and Comprehensive Employment and Training Act programs.

In your letter, you ask for an explanation of the legal basis for the making of nine of those grants. You also raise the question of whether the nine grants further Federal, rather than State, operations.

As shown below, the purpose of the grants is to enhance, and to make more efficient, the employment security and training activities of all States. This method of making grants provides an economical way to improve management and operations at each of the individual State employment security agencies, including the NESD. Set forth below are descriptions of the general program areas under which the nine grants were made, along with a description of the Secretary of Labor's grantmaking authority for each program.

The Congress established the Federal-State cooperative unemployment compensation system in 1935, by passage

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of the Social Security Act. 49 Stat. 626. Under Title III of that Act, States which pass unemployment compensation laws meeting specific requirements may receive grants for the administration of their unemployment compensation programs. 42 U.S.C. 501 et seq. The Federal-State cooperative system of employment service offices was permitted to receive funds for administration under Title III of the Social Security Act (as well as separate appropriations). 29 U.S.C. 49d.

It has been the position of the Department of Labor and other agencies that have administered the Title III grant program (e.g., the Social Security Board and the Federal Security Agency) that there is a broad discretion in the Federal administering agency, as to both the amount and the purpose of the grants. The Comptroller General has recognized this broad discretion for many years. See 21 Comp. Gen. 1119, 1124-1125 (June 19, 1942). The Comptroller General stated in that opinion that payments under Title III of the Social Security Act may be disallowed only when "clearly beyond the scope and purposes of the statute". Id. This longstanding approach is discussed more fully in a September 15, 1960, Solicitor of Labor's opinion, a copy of which is enclosed.

The Secretary of Labor certifies to the Secretary of the Treasury that Title III funds may be paid out, in such amounts and for such purposes as he determines to be necessary. 42 U.S.C. 502(a), 503(a)(8) and (9); and 29 U.S.C. 49g. The standard followed by the Secretary of Labor is that the funds must be used by the States for "the proper and efficient administration" of the State unemployment compensation law and employment service offices. Id. As the Federal Security Administrator (who then administered Title III) stated in a September 27, 1949, letter to the Comptroller General (who did not except to the statement):

> It is respectfully submitted that by virtue of the provisions of Title III of the Social Security Act, particularly sections 302(a), 303(a)(8), and 303(a)(9), the responsibility for determination

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> of the amounts necessary for the proper and efficient administration of State unemployment compensation laws, and the purposes for which such funds may be expended by the States, is vested solely in the Social Security Board [and now in the Secretary of Labor].

See also Solicitor of Labor's opinion, supra, at 8.

"[P]roper and efficient administration" of the State unemployment compensation and employment service activities is the basis for all of the Social Security Act Title III grants to the NESD which were questioned in your letter. Rather than giving individual grants to each State agency for studies and development of model management programs, grants were given to one agency to inure to the benefit of all. States given "pass-through" grants generally are chosen for their relatively low personnel and other management costs. This results in a larger proportion of each grant dollar going for non-administrative costs.

The NESD did not receive any less money than was necessary for the proper administration of its programs. The grants questioned are in addition to the normal administrative costs of the NESD. Nevertheless, we have been told that the granting officer has found that the grants involved add to the efficient administration of the NESD and other States' employment security agencies.

In the case of employment service activities, this method of procurement appears to be the sole available means of obtaining studies and conducting projects that are beneficial to the entire employment service system. The alternative would be the inefficient and costly method of giving piece-meal grants to each individual State agency for such studies and projects. Thus, pass-through grants act to the benefit of the individual States and of the United States, by saving grant money and by more efficiently advancing the purposes of Title III.

To point up the added efficiency due to these grants, refer to the four NESD grants funded with unemployment

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insurance monies. These grants relate to the development and perfection of Unemployment Insurance Cost Models. Similar projects in the past have saved the Federal Government millions of dollars, by improving the efficiency and performance of State employment security agencies. See Labor-HEW Appropriations Act, 1976: Hearings Before a Subcommittee of the House Committee on Appropriations, Part 5, 94th Cong., 1st Sess. 323-324 (testimony of Dr. Ben Burdetsky, Deputy Assistant Secretary of Labor for Manpower)(May 5, 1975).

The Congress is well aware of the "pass-through" approach to funding projects benefiting all State employment security agencies. In 1962, the following exchange, relating to unemployment insurance programs, took place before a subcommittee of the House Committee on Appropriations:

> MR. DENTON: What I am talking about and trying to get at, you make contracts.
>
> MR. LEVINE: Oh, we make contracts. We have a request for $135,000 for contract research. Hitherto, all of our research has been handled through either Federal staff, directly doing types of things, or, and by far the vast preponderance, has been by grants through Title III of the Social Security Act. [Emphasis added.]

Labor-HEW Appropriations Act, 1963: Hearings Before a Subcommittee of the House Committee on Appropriations, 87th Cong., 2d Sess. 432 (discussion between Mr. Louis Levine, Deputy Director for Program and Policy, Bureau of Employment Security, U. S. Department of Labor; and Congressman Winfield K. Denton)(January 23, 1962).

No legislative restriction on such grant procedures was placed into the Act or appropriations Acts as a result of this exchange.

The Comprehensive Employment and Training Act (CETA) and Work Incentive (WIN) Program grants mentioned in your letter derive from funds appropriated for the Secretary of Labor's discretionary use. See 29 U.S.C. 881-885 (1975 supp.); and 42 U.S.C. 641-642.

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The CETA grants in question include agreements relating to the development and evaluation of labor market statistics and job opportunities bank systems. These purposes are set forth specifically in 29 U.S.C. 882 (1974 supp.). As with the employment service and unemployment compensation grants described above, the grant officer determined that it was consistent with the statutory purposes, and inured to the benefit of all the participating States, as well as the Federal Government, to expend program funds in this manner. The efficiency of channeling funds through one State agency for the benefit of all, rather than on a piecemeal basis to each agency, is readily apparent. The State agency is not prejudiced by being awarded such pass-through grants, since these grants in no way dilute its fair share of funds for the administration of its State laws, and it, along with all the other States, becomes the beneficiary of these expenditures. Funds could have been granted to another State's employment security agency to oversee the projects involved. Of course, withdrawal of such grants from the NESD might result in a net loss in job slots for the agency, reflecting its lowered workload.

The WIN grant referenced in your letter derives from discretionary funds allocated to the Secretary of Labor by 42 U.S.C. 641-642 and 29 CFR § 56.14(b). The grant funded development of a revised WIN Financial Management Seminar package to provide technical assistance to WIN program sponsors in operating WIN programs in the States. In the exercise of the Secretary's lawful discretion, his designee determined that it best served the Congressionally-mandated objectives of the WIN Program to make the grant at issue which under the terms of the discretionary authority of 42 U.S.C. 641-642 is available for such technical assistance. The efficiencies and benefits to the Federal Government cited for the various grant programs discussed above apply as well to the WIN grant.

Sincerely,

Carin Ann Clauss
Solicitor of Labor

Enclosure

cc: Ernest G. Green, Assistant Secretary, ETA
Marjorie Fine Knowles, Inspector General