



Audit Report

NorthgateArinso, Inc.

**A Texas Health and Human Services
Commission Contractor**



**Inspector
General**

**Texas Health
and Human Services**

**August 20, 2021
OIG Report No. AUD-21-024**



NorthgateArinso, Inc.

A Texas Health and Human Services Commission Contractor

WHAT OIG FOUND

NorthgateArinso, Inc. (NGA) reported costs on the 2019 and 2020 Retrospective Cost Settlement (RCS) statements that were unsupported and unallowable; however, the total incurred costs exceeded the fee ceiling for each contract year. Therefore, no refund is due to the Texas Health and Human Services Commission (HHSC). The Texas Health and Human Services (HHS) Office of Inspector General Audit and Inspections Division (OIG Audit) identified \$370,064 in contract year 2019 and \$543,690 in contract year 2020 in overstated expenses on the RCS statements due to:

- Insufficient controls to ensure the RCS statement costs were reasonably stated and supported.
- Improper use of estimates to record expenses incurred.
- Insufficient supporting documentation provided for certain selected expenses.
- Reconciliation variances and calculation errors in RCS statement preparation workbooks and other supporting documentation.
- Unallowable expense transactions and general ledger accounts.
- Expenses based on improper cutoff at the beginning and end of contract years.
- Transactions based on an accounting method not recognized by generally accepted government accounting principles (GAAP).

Tables 1 and 2 provide a summary of the OIG Audit adjustments to the 2019 and 2020 RCS statements.

Table 1: Summary of OIG Audit Adjustments to the 2019 RCS Statement

Expense Category	Unadjusted	Adjustments	Final Adjusted
Salaries	\$2,917,457	(\$ 8,819)	\$2,908,638
Fringe Benefits	1,312,931	(29,517)	1,283,414
Data Center	2,120,328	(227,974)	1,892,354
Indirect Expenses – Round Rock (15.8%)	1,248,331	(42,077)	1,206,254
Administrative Service Fee (20%)	1,918,846	(61,677)	1,857,169
Total Adjustments		(\$370,064)	

Source: NGA, HHSC, and OIG Audit

Table 2: Summary of OIG Audit Adjustments to the 2020 RCS Statement

Expense Category	Unadjusted	Adjustments	Final Adjusted
Fringe Benefits	\$1,253,771	(\$ 58,491)	\$1,195,280
Data Center	2,195,719	(332,765)	1,862,954
Indirect Expenses – Round Rock (15.8%)	1,425,980	(61,819)	1,364,161
Administrative Service Fee (20%)	2,144,045	(90,615)	2,053,430
Total Adjustments		(\$543,690)	

Source: NGA, HHSC, and OIG Audit

BACKGROUND

For each contract year, HHSC set a fee ceiling, which was the maximum payment amount to NGA. Payments to NGA were reimbursements for the actual costs incurred plus an additional amount for indirect costs and administrative fees. If the total amount of actual costs incurred plus indirect costs and administrative fees exceeded the fee ceiling, HHSC’s payment to NGA was limited to the amount of the fee ceiling. NGA was permitted to incur expenses beyond the fee ceiling and reported all expenses on RCS statements that were submitted to HHSC each year and summarized the allowable costs incurred during the contract year.

WHY OIG CONDUCTED THIS AUDIT

NorthgateArinso, Inc. (NGA) became the outsourced human resources and payroll contractor for the Texas Health and Human Services Commission (HHSC) on May 1, 2013. Under the contract, NGA provides human resource services; shared services; payroll and financial services; and service center and call center services. HHSC paid NGA \$11.9 million for contract year 2019 and \$13.3 million for contract year 2020.

OIG Audit conducted this audit at the request of HHSC. The audit objectives were to determine whether (a) the Retrospective Cost Settlement (RCS) statements for the unaudited periods of the original contract, as amended, with HHSC, contract years 2019 and 2020, were reasonably stated and (b) NGA was in compliance with a selected renewal contract requirement for information security.

The results of testing related to the information security objective are discussed in a separate report provided to authorized personnel.

WHAT OIG RECOMMENDS

NGA should:

- Implement a robust internal control process for RCS statements.
- Ensure that only allowable costs are reported on RCS statements.
- Ensure proper document retention.
- Implement a robust process to ensure that information security contract requirements are met.

MANAGEMENT RESPONSE

NGA provided management responses to the recommendations, generally indicating that it will review RCS statement requirements. NGA disagreed that the selected information security requirement is vulnerable to violation of contractual obligations. NGA stated that while it is confident that its current policies and controls are effective in ensuring contractual information security requirements are met, it will take action to further review and assess best practices and additional controls.

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INTRODUCTION

The Texas Health and Human Services (HHS) Office of Inspector General Audit and Inspections Division (OIG Audit) conducted an audit of NorthgateArinso, Inc. (NGA). NGA became the outsourced human resources and payroll contractor for the Texas Health and Human Services Commission (HHSC) on May 1, 2013. The categories of services under the contract include:

- Human resource services
- Shared services
- Payroll and financial services
- Service center and call center services

Unless otherwise described, any year referenced is the contract year, which covers the period from (a) May 1, 2018, through April 30, 2019, for 2019 and (b) May 1, 2019, through May 31, 2020 for 2020.

Background

The total cost of the entire contract period, effective May 1, 2013, through May 31, 2020,¹ was not to exceed \$83 million.² For each contract year, HHSC set a fee ceiling, which was the maximum payment amount to NGA based on a combination of fixed and variable fees. Payments to NGA were reimbursements for the actual costs incurred plus an additional amount for indirect costs and administrative fees. Indirect costs were recorded as a 15.8 percent markup of local Texas office (Round Rock) direct non-pass-through costs, which represented overhead and general and administrative costs. The administrative fee is a 20 percent markup applied to all allowable non-pass-through costs. If the total amount of actual costs incurred plus indirect costs and administrative fees exceeded the fee ceiling, HHSC's payment to NGA was limited to the amount of the fee ceiling. NGA was permitted to incur expenses beyond the fee ceiling and reported all expenses on Retrospective Cost Settlement (RCS) statements that were submitted to HHSC each year and summarized the allowable costs incurred during the contract year.

Certain types of costs identified in NGA's contract with HHSC as pass-through expenses³ were ineligible for the additional indirect or administrative fees and reported separately on the RCS statements.

¹ Texas HHSC contract #529-13-0001-00001 (May 1, 2013), as amended, was extended through May 2020 to allow the new contract period to be effective June 1, 2020.

² Texas HHSC contract #529-13-0001-00001 (May 1, 2013), as amended.

³ In the context of this report, a "pass-through" expense is a type of cost identified by HHSC that is precluded from the 15.8 percent markup for indirect costs and the 20 percent administrative fee.

For the first five contract years, the RCS statements were audited by an independent accounting firm. These annual examination engagements resulted in an opinion as to whether NGA incurred unallowable costs resulting in a refund due to HHSC. HHSC requested that OIG perform an audit of the RCS statements for contract years 2019 and 2020. The previous years' RCS statement audit reports cited significant issues, most notably a departure from generally accepted accounting principles (GAAP).

NGA's preparation of the RCS statements involved compiling transaction and other data from the corporate general ledger and subledger systems into Microsoft Excel workbooks, which were manually developed and maintained to calculate and categorize the expenses for inclusion in each RCS statement submitted to HHSC.

NGA reported combined expenses and fees totaling \$12.5 million in 2019 and \$14 million in 2020; however, these amounts exceeded the fee ceiling for each year. Therefore, HHSC paid NGA the fee ceiling amounts of \$11.9 million for 2019 and \$13.3 million for 2020. Table 1 details these amounts in 2019 and 2020.

Table 1: NGA Expenses and Fee Ceiling Amounts Paid to NGA

Item	2019	2020
NGA Combined Expenses and Fees	\$12,459,401	\$13,962,014
Fee Ceiling Amount Paid to NGA	11,878,424	13,257,913
Difference	\$580,977	\$704,101

Source: OIG Audit

Alight Inc., an international payroll and human resources company, acquired NGA in 2019. During the initial integration period between Alight and NGA, HHSC awarded a renewal contract to NGA, which became effective June 1, 2020. The fully executed contract agreement included specific requirements related to protecting the security of the HHSC employees' personal information, which NGA must access to perform the contracted services. However, the specific details of the objective, scope, criteria, and issues identified from this portion of the audit were incorporated in a separate report provided to authorized personnel.

Objective and Scope

The audit objectives were to determine whether (a) the RCS statements for the unaudited periods of the original contract, as amended, with HHSC, contract years 2019 and 2020, were reasonably stated and (b) NGA was in compliance with a selected renewal contract requirement for information security.⁴

⁴ Texas HHSC contract #HHS000366600001, Exhibit B, § 3.13 (June 1, 2020).

For the RCS statements, the audit scope included (a) the period from May 1, 2018, through April 30, 2019, for contract year 2019 and (b) the period from May 1, 2019, through May 31, 2020,⁵ for contract year 2020. The audit scope also included the period from June 1, 2020, through the end of fieldwork in June 2021 for the selected contract requirement related to information security. The audit included a review of NGA's internal control as well as testing of controls that were significant within the context of the audit objectives.

Methodology

To accomplish its objective related to the RCS statements, OIG Audit (a) interviewed NGA personnel and (b) collected and analyzed relevant documentation from NGA related to the preparation of the RCS statements for contract years 2019 and 2020. Such documents included but were not limited to general ledger account listings, payroll registers, journal entries, allocation calculations, invoices, and subcontracts.

To accomplish its objective related to the contract requirement for information security, OIG Audit (a) interviewed NGA personnel and (b) performed testing of relevant corporate policies, internal employee training, and access to applications utilized for HHSC data.

Details about the methodology are provided in Appendix A.

OIG Audit presented preliminary audit results, issues, and recommendations to NGA in a draft report dated July 21, 2021. NGA provided management responses to the recommendations, generally indicating that RCS statements will undergo a thorough review to ensure available actual costs are included and are free from errors. NGA disagreed that the selected information security requirement is vulnerable to violation of contractual obligations. NGA stated that while it is confident that its current policies and controls are effective in ensuring contractual information security requirements are met, it will take action to further review and assess best practices and additional controls.

Criteria

OIG Audit used the following criteria to support the issues included in this report:

- 48 C.F.R. §§ 31.201-2 (2004) and 31.205-20 (1999)
- Texas HHSC Request for Proposals (RFP) for Human Resources and Payroll Services (HRPS), RFP #529-13-0001 (2012)

⁵ Texas HHSC contract #529-13-0001-00001 (May 1, 2013), as amended, was extended through May 2020 to allow the new contract period to be effective June 1, 2020.

- Texas HHSC contract #529-13-0001-00001 (2013), as amended
- Texas HHSC contract #HHS000366600001 (2020)
- U.S. Generally Accepted Accounting Principles, the Financial Accounting Standards Board (FASB) Accounting Standards Codification, Topic 830-10-55-11, v. 8.0 (current as of July 12, 2021).

Auditing Standards

Generally Accepted Government Auditing Standards

We conducted this performance 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.

AUDIT RESULTS

OIG Audit identified \$370,064 and \$543,690 in overstated expenses on the 2019 and 2020 RCS statements, respectively. However, because NGA's unadjusted RCS statements reported costs plus applicable indirect and administrative fees exceeded the fee ceiling by \$580,977 for 2019 and \$704,101 for 2020, the total adjusted costs incurred plus the indirect and administrative fees in both years were still greater than the respective annual fee ceilings.⁶ Therefore, no refund is due to HHSC.

The expenses were overstated primarily due to duplicate transactions, insufficient support for selected expenses, the improper use of accounting estimates, and the inclusion of unallowable interest expense.

The RCS statements are specialized, program-level income statements developed by and for the use of HHSC to monitor contractors' spending. Due to the specialized nature of these statements, NGA developed a separate internal process to compile and calculate the various components needed to populate the RCS statements. Because some of the allowable cost requirements and pass-through expenses are unique to HHSC contracts and are not typically addressed at the corporate accounting level, the preparation of RCS statements requires significant manual intervention and review to ensure compliance with reporting requirements. NGA demonstrated a good understanding of the requirements under the HHSC contract and has developed complex workbooks to extract relevant general ledger transactions, calculate rates and allocations, and categorize expenses into the appropriate RCS statement format. However, NGA did not have a robust review process and, as a result, did not identify errors in its calculations and reported costs prior to submission to HHSC.

⁶ In the context of this report, the "unadjusted RCS statements" refer to the RCS statements as originally prepared and submitted to HHSC by NGA. The "adjusted RCS costs" refer to adjustments prepared by OIG Audit as a result of the disallowed costs identified in this report.

Tables 2 and 3 provide a summary of the OIG Audit adjustments and resulting recalculated indirect cost⁷ and administrative fee amounts to the 2019 and 2020 RCS statements.

Table 2: Summary of OIG Audit Adjustments to the 2019 RCS Statement

Expense Category	Unadjusted	Adjustments	Final Adjusted	Associated Issue
Non-Pass-Through Expenses				
Salaries	\$2,917,457	(\$8,819)	\$2,908,638	1.1
Fringe Benefits	1,312,931	(29,517)	1,283,414	1.1
Data Center	2,120,328	(227,974)	1,892,354	1.2
Indirect Expenses – Round Rock (15.8%)	1,248,331	(42,077)	1,206,254	
Administrative Service Fee (20%)	1,918,846	(61,677)	1,857,169	
Total Adjustments		(\$370,064)		

Source: NGA, HHSC, and OIG Audit

Table 3: Summary of OIG Audit Adjustments to the 2020 RCS Statement

Expense Category	Unadjusted	Adjustments	Final Adjusted	Associated Issue
Non-Pass-Through Expenses				
Fringe Benefits	\$1,253,771	(\$ 58,491)	\$1,195,280	1.1
Data Center	2,195,719	(332,765)	1,862,954	1.2
Indirect Expenses – Round Rock (15.8%)	1,425,980	(61,819)	1,364,161	
Administrative Service Fee (20%)	2,144,045	(90,615)	2,053,430	
Total Adjustments		(\$543,690)		

Source: NGA, HHSC, and OIG Audit

The detailed unadjusted and adjusted 2019 and 2020 RCS statements are presented in Appendix B.

The results of testing related to the information security objective of this audit are discussed in a separate report provided to authorized personnel.

⁷ The OIG Audit adjustments resulted in a recalculated indirect cost for Round Rock direct expenses. Non-Round Rock direct expenses were not selected for testing; therefore, the non-Round Rock indirect cost did not result in an adjustment.

Issue 1: NGA Did Not Have Sufficient Controls to Ensure Reported Costs on the RCS Statements Were Reasonably Stated and Adequately Supported

All expenses reported on the RCS statements must be incurred, adequately supported, and allocable to the contract to be allowable.^{8,9} NGA's expenses reported on the 2019 and 2020 RCS statements included both (a) direct charges for expenses incurred specifically for services provided to HHSC and (b) an allocation of costs from corporate cost centers that form a data center cost pool. The expenses in the data center cost pool are allocated to the RCS statements using a complex methodology that is primarily based on an overall cost per server that is applied to the HHSC-dedicated servers. Internal server costs are allocated across NGA's customers.

NGA calculates and populates the RCS statements using workbooks containing (a) transactional data from the corporate general ledger system and (b) other information compiled from various departments within the organization. These workbooks were internally developed and populated by NGA staff to synthesize and aggregate the data into the format needed to populate the RCS statement template from HHSC.

Although the dollar adjustments resulting from the audit did not result in a reduction of total cost significant enough to warrant a refund due to HHSC, OIG Audit identified weaknesses in the internal controls surrounding NGA's preparation of the RCS statements. The weaknesses identified were based on the following errors identified during the audit:

- Improper use of estimates to record expenses incurred.
- Insufficient supporting documentation provided for certain selected expenses.
- Reconciliation variances in RCS statement preparation workbooks and other supporting documentation.
- Calculations incorporating duplicate, inaccurate, or outdated data elements.
- Unallowable expense transactions and general ledger accounts.

⁸ 48 C.F.R. § 31.201-2 (Apr. 5, 2004).

⁹ Texas HHSC contract #529-13-0001-00001, Exhibit B, No. 2 (May 1, 2013), as amended, states that the contractor confirms it will follow GAAP and 48 C.F.R. §§ 30 and 31.

- Expenses based on improper cutoff at the beginning and end of contract years.
- Transactions based on an accounting method not recognized by GAAP.

Significant adjustments to the RCS statements resulted from the issues identified during the audit. Additionally, OIG Audit noted other reporting errors, such as a blank caption¹⁰ title for the IBM Corporation costs reported on the 2019 RCS statement originally submitted to HHSC and the reporting of an amount in the 2019 Training and Events caption that was intended to be incorporated into a different caption. NGA stated there are no formal reviews or documented policies and procedures for the RCS statement preparation.

Detailed results are presented in the sections that follow.

SALARIES AND FRINGE BENEFITS COSTS

The Salaries and Fringe Benefits captions on the RCS statements for 2019 and 2020 represent costs incurred to employ personnel who were entirely dedicated to the HHSC contract. A portion of the fringe benefits costs was for self-insured corporate health care expenses that were allocated to the RCS statements based on a cost per full-time employee.

Issue 1.1: Unallowable Salaries and Fringe Benefits Expenses

NGA reported unallowable expenses on the Salaries and Fringe Benefits RCS statement captions in both 2019 and 2020. In both years, OIG Audit identified expenses that were not accurately reported, adequately supported, or reconciled.

The OIG Audit adjustments to the RCS statements for 2019 resulting from the findings discussed in Issue 1.1 are summarized in Table 4.

Table 4: Unallowable Costs for Salaries and Fringe Benefits in 2019

Finding	RCS Caption	Amount
Unallowable Use of Estimates	Fringe Benefits	\$11,868
Insufficient Support	Salaries	8,819
	Fringe Benefits	5,706
Reconciliation, Calculation, and Keying Errors	Fringe Benefits	11,943
Total		\$38,336

Source: OIG Audit

¹⁰ A “caption” represents a line item on the face of the RCS statement.

The OIG Audit adjustments to the RCS statements for 2020 resulting from the findings discussed in Issue 1.1 are summarized in Table 5.

Table 5: Unallowable Costs for Fringe Benefits in 2020

Finding	RCS Caption	Amount
Unallowable Use of Estimates	Fringe Benefits	\$51,651
Insufficient Support		4,429
Reconciliation, Calculation, and Keying Errors		2,411
Total		58,491

Source: OIG Audit

Unallowable Use of Estimates

NGA reported 401(k) retirement plan employer contributions using an estimated percentage of direct salaries because the RCS statement preparer did not have actual employer contribution data as of the time of the submission of the RCS statements to HHSC. NGA is required to report costs at the amount incurred.¹¹ Once notified of the issue by OIG Audit, NGA staff provided the amounts of actual contributions for 2019 and six months of actual contributions for 2020. The variance between the estimated costs originally reported and the actual employer 401(k) contributions paid was \$11,868 in 2019 and \$51,651 in 2020.

Insufficient Support

NGA did not provide sufficient evidence to validate certain transactions in the direct labor costs selected for detail testing. NGA must (a) appropriately account for costs and (b) maintain records and supporting documentation adequate to demonstrate that costs claimed were incurred, allocable to the contract, and in compliance with applicable cost principles.¹²

In 2019, 6 of 25 payroll transactions and 3 of 10 health insurance benefits transactions selected for testing were disallowed due to insufficient support provided. As a result, \$8,819 was disallowed in the Salaries caption and \$5,706 was disallowed in the Fringe Benefits caption. Similarly, \$4,429 for one of the ten selected health insurance benefit transactions was disallowed due to insufficient support in the 2020 RCS statement's Fringe Benefits caption.

Reconciliation, Calculation, and Keying Errors

The reconciliation of employee bonus direct costs is a manual calculation to remove costs greater than ten percent of an individual's salary in order to comply

¹¹ 48 C.F.R. § 31.201-2(d) (Apr. 5, 2004).

¹² 48 C.F.R. § 31.201-2(d) (Apr. 5, 2004).

with the contractual limit.¹³ In 2019, OIG Audit identified that 3 of 47 total employee bonuses reported in the direct Fringe Benefits caption on the RCS statements were for indirect labor employees. In 2020, OIG Audit identified that (a) one of 41 total employee bonuses reported in the direct Fringe Benefits caption on the RCS statements were for indirect labor employees and (b) the bonus limits for two employees were calculated incorrectly. These issues combined resulted in disallowed costs of \$8,943 in 2019 and \$2,411 in 2020. Furthermore, one of ten selected transactions in the fringe benefits sample in 2019 was entered into the general ledger incorrectly, resulting in an additional overstatement in 2019 of \$3,000.

Recommendation 1.1

NGA should improve the process for preparing the Salaries and Fringe Benefits captions on the RCS statements, including:

- Implementing a robust internal control process to ensure that RCS statements and the supporting materials used to prepare them are accurate and include only allowable costs.
- Ensuring that only actual allowable direct labor costs are reported on RCS statements and maintaining sufficient supporting documentation for such costs.

Management Response to Recommendations 1.1 and 1.2

As we complete the integration between NGA and Alight, we will review all reconciliation and data retention process to ensure the best possible availability of RCA supporting data to HHSC. In the new contract effective 6/1/2020, the data center associated cost will be a fixed fee allocation and will not allow reconciliation to actual cost. All other findings will be addressed by the following Action Plans:

Action Plan

1. *Prior to submitting the final RCS Statements, we will reconcile all estimates to actual costs available to us at the time of submission. There may be some estimates/accruals depending on the timing of actual invoices and RCS submission, but the Financial Analyst will complete a thorough review to ensure all available actual costs are included in the final RCS Submission.*

¹³ Texas HHSC Request for Proposals (RFP) for Human Resources and Payroll Services (HRPS), § 6.5, Part 6.5.1, RFP #529-13-0001 (Feb. 17, 2012).

2. *All RCS statements and supporting worksheets will undergo a thorough 2 party review in order to ensure all final statements submitted to HHSC are free of formula and other data entry errors.*

Responsible Manager

Senior Business Analyst

Target Implementation Date

August 1, 2021, as part of RCS 1

DATA CENTER COSTS AND ALLOCATION

The Data Center caption on the RCS statements represents an allocation from a corporate cost pool of expenses incurred for maintaining and supporting the production; disaster recovery; and development, quality assurance, and test data center environments for the HHSC contract.¹⁴ The cost pool of relevant expenses in the allocation to the RCS statements includes labor; hardware and software capital expenditures; depreciation and amortization of the capital expenditures; equipment maintenance; and other administrative fees. After the cost pool is identified, NGA allocates the expenses in the cost pool proportionately to all clients, including HHSC, primarily based on the number of client-dedicated servers and NGA's internal servers.

Issue 1.2: Unsupported and Unallowable Data Center Costs

The total corporate data center cost pool amount prior to the allocation to the RCS statements was \$19,204,053 in 2019 and \$15,968,599 in 2020. OIG Audit identified unsupported or unallowable costs in the cost pool of \$2,430,943 in 2019 and \$1,554,076 in 2020 due to insufficient support provided to OIG Audit by NGA, improper foreign currency translation, improper use of estimates, improper cutoff, duplication of costs, and unallowable costs. Additionally, NGA reported an additional \$168,901 in unallowable estimated data center costs on the RCS statement for 2020.¹⁵ As a result of these findings, OIG Audit recalculated the data center allocation to the RCS statements, which resulted in the adjustments to the costs reported in the Data Center caption on the RCS statements of \$227,974 and \$332,765 in 2019 and 2020, respectively.

¹⁴ Texas HHSC Contract #529-13-0001-00001, Exhibit B, No. 24 (May 1, 2013), as amended.

¹⁵ The additional amount was not included in the cost pool; instead, it was recorded directly to the Data Center caption on the RCS statement as shown in Table 7.

The cost pool adjustments and resulting allocated cost adjustment in 2019 are detailed in Table 6.

Table 6: Data Center Unallowable Costs in 2019 by Finding

Finding	Pre-Allocation Amount
Duplicated Costs	\$1,715,951
Insufficient Support	494,457
Unallowable Use of Estimates	133,511
Unallowable Expenses	84,179
Improper Cutoff	2,845
Total Cost Pool Adjustment	\$2,430,943
Total Allocated RCS Statement Adjustment	\$ 227,974

Source: *OIG Audit*

The cost pool adjustments and resulting allocated cost adjustment in 2020 are detailed in Table 7.

Table 7: Data Center Unallowable Costs in 2020 by Finding

Finding	Pre-Allocation Amount
Cost Pool Revision from NGA	\$ 533,459
Duplicated Costs	81,450
Insufficient Support	608,261
Unallowable Use of Estimates	118,979
Unallowable Expenses	211,743
Foreign Currency Translation Issues	184
Total Cost Pool Adjustment	\$1,554,076
Unallowable Use of Estimates – After Allocation	\$ 168,901
Total Allocated RCS Statement Adjustment	\$ 332,765

Source: *OIG Audit*

Duplicated Costs

In NGA's data center allocation workbook, there was a formula error in the summary of costs by category that resulted in the duplication of \$1,715,951 in the depreciation and amortization cost category in 2019. Additionally, one of five selected U.S. employee payroll transactions was also reported in the direct salaries costs in 2020. Upon further review of the data center payroll costs, OIG Audit noted that the employee's costs were duplicated in direct salaries and data center payroll costs for the entire contract year. Since NGA stated that this employee's work is directly related to the HHSC contract, OIG Audit disallowed the duplicated cost of \$81,450 and removed it from the data center cost pool.

Insufficient Support

NGA is required to maintain records and supporting documentation adequate to demonstrate that costs claimed were incurred, allocable to the contract, and in compliance with applicable cost principles.¹⁶ NGA did not provide sufficient support to validate data center expenses in the corporate cost pool in the amounts of \$494,457 and \$608,261 for 2019 and 2020, respectively. These amounts include transactions selected for testing and categories of costs that were unsupported as detailed below.

For 2019, OIG Audit identified:

- \$324,477 for unsupported international payroll transactions
- \$169,980 for unsupported selected non-payroll transactions

For 2020, OIG Audit identified:

- \$334,444 for international payroll transactions
- \$165,660 for unsupported recurring non-payroll charges
- \$94,339 for unsupported selected international employee payroll transactions
- \$13,818 for an unsupported selected non-payroll transaction

For six international employee payroll transactions selected for testing in 2020, OIG Audit did not receive any reliable evidence that the transactions occurred. Since NGA did not support the validity of payroll expenses in the countries where the employees were located, OIG Audit disallowed all payroll transactions in those countries from the data center cost pool. This resulted in (a) 71 transactions totaling \$324,477 as unallowable in 2019 and (b) 20 transactions in addition to the six sample selections totaling \$334,444 as unallowable in 2020.

Unallowable Use of Estimates

NGA used estimates for expenses where actual cost information and support was not readily available; however, a cost must have been incurred to be allowable.¹⁷ OIG Audit disallowed costs that were not supported by actual cost data. Similar to the issue surrounding the direct labor costs identified in Issue 1.1, NGA estimated the 401(k) employer contribution amounts that it included in its data center cost pool for 2019 and 2020, resulting in disallowed costs of \$133,511 in 2019 and \$118,979 in 2020.

¹⁶ 48 C.F.R. § 31.201-2(d) (Apr. 5, 2004).

¹⁷ 48 C.F.R. § 31.201-2(d) (Apr. 5, 2004).

Additionally, NGA's 2020 contract was extended to include a thirteenth month, and the additional costs were to be reported on the RCS statement; however, to record the additional month's costs, NGA prorated the 12-month allocated cost by adding \$168,901 directly to the RCS Data Center caption. NGA subsequently provided a revised data center allocation workbook that included actual transactions for May 2020 from the cost pool's general ledger accounts. Therefore, OIG Audit disallowed the \$168,901 estimation and included the May 2020 actual expenses in the population for sample selection and detail testing.

Unallowable Expenses

The Data Center cost pool included expenses that did not adhere to the contract criteria for allowability.^{18,19} OIG Audit identified 2 of 25 selected transactions in 2019 totaling \$2,563 as unallowable late fees and interest on financing of capital expenditures. Upon further review of the general ledger of expenses in the cost pool for similar issues, OIG Audit also identified \$4,661 for two additional interest expense transactions related to the same capital expenditure. NGA also included \$76,955 in unallowable interest expenses in its own general ledger account within the cost pool in 2019.

In 2020, OIG Audit found 4 of 25 selected transactions included unallowable late fees and interest on financing capital expenditures totaling \$43,097. Upon further inspection of the general ledger for similar issues, 88 transactions totaling \$138,684 were unallowable interest expenses. OIG Audit also found that the cost pool included unallowable overhead allocations and employee bonuses over the ten percent limit; therefore, OIG Audit disallowed an additional \$29,962.

In total, the unallowable late fees and interest expenses resulted in \$84,179 in adjustments to the 2019 RCS statements and \$211,743 in adjustments to the 2020 RCS statements.

Improper Cutoff

OIG Audit found 5 of the 25 transactions selected for detail testing in 2019 and 3 of the 25 selected transactions in 2020 included costs that were incurred in the previous contract year. The explanations of the exceptions are as follows:

- \$2,845 in 2019 was disallowed for one transaction directly related to improper cutoff.

¹⁸ Texas HHSC Request for Proposals (RFP) for Human Resources and Payroll Services (HRPS), §§ 6.4, Part 6.4.1, and 6.5, Part 6.5.1, RFP #529-13-0001 (Feb. 17, 2012).

¹⁹ 48 C.F.R. § 31.205-20 (Sept. 24, 1999).

- One of the selected transactions from 2020 with improper cutoff issues was also unallowable for insufficient support and was reported in the Insufficient Support section of this issue.
- Three of the selected transactions from 2019 and the three selected transactions from 2020 with improper cutoff issues did not result in a disallowed amount. Each of the selected amounts represented annual recurring costs; therefore, the total cost incurred during the reporting period was accurate. However, the specific invoices recorded in the general ledger were based on dates outside the reporting periods, which creates a risk of inaccurate reporting should rates, vendors, or the timing of payment change.

Foreign Currency Translation Issues

OIG Audit found that expenses incurred in foreign currencies were not translated according to GAAP, which requires that currency exchange rates are based upon a weighted average for transactions incurred during the reporting period.²⁰ This is a recurring finding from RCS statement audit reports from a previous independent accounting firm.

OIG Audit identified 2 of 25 selected transactions were incurred in foreign currencies, and \$184 was the total overstated variance in methodologies. OIG Audit also selected ten non-United States labor transactions where foreign currency translation issues were identified; however, the transactions were identified as underreported, or the finding was reported under the insufficient support issue as there was insufficient information to determine the allowable amount related to translations. NGA was not permitted to record additional allowable direct expenses on the RCS statements after the final reports were submitted to HHSC.²¹

Recommendation 1.2

In addition to strengthening its internal control process as described in Recommendation 1.1, NGA should:

- Ensure proper document retention and availability as required.

Management Response Recommendations 1.2

The management response to Issue 1.2 was combined with the management response for Issue 1.1 and presented following Issue 1.1.

²⁰ U.S. Generally Accepted Accounting Principles, the Financial Accounting Standards Board (FASB) Accounting Standards Codification, Topic 830-10-55-11, v. 8.0 (current as of July 12, 2021).

²¹ Texas HHSC Request for Proposals (RFP) for Human Resources and Payroll Services (HRPS), § 6.9, Part 6.9.3.1, RFP #529-13-0001 (Feb. 17, 2012).

INFORMATION SECURITY CONTROLS

The issue that follows concerns the selected information security contract requirement.

Issue 2: NGA Did Not Have Sufficient Controls to Ensure Compliance with the Selected Information Security Requirement

Pursuant to Standard 9.61 of *Government Auditing Standards* issued by the Comptroller General of the United States, certain information was omitted from this report because the information was deemed to present potential risks related to public safety, security, or the disclosure of private or confidential data. Under the provisions of Texas Government Code Section 552.139, the omitted information is also exempt from the requirements of the Texas Public Information Act.

Details of this issue were communicated in a separate report provided to authorized personnel.

Recommendation 2

NGA should implement a robust process to ensure that information security contract requirements are met.

Management Response

Action Plan

NGA disagreed that the issues identified by OIG Audit result in vulnerability to violation of the selected information security requirement. NGA stated that while it is confident that its current policies and controls are effective in ensuring contractual information security requirements are met, it will take action to further review and assess best practices and additional controls.

Responsible Manager

Senior Director, Account and Site Operations

Target Implementation Date

September 1, 2021

Auditor Comment

OIG Audit appreciates the feedback provided by NGA in its management response and respects NGA's position on the reported issues. OIG Audit stands by its findings and conclusions.

CONCLUSION

NGA reported costs on the 2019 and 2020 RCS statements that were unsupported and unallowable; however, the total incurred costs exceeded the fee ceiling for each contract year. Therefore, no refund is due to HHSC. OIG Audit identified \$370,064 in 2019 and \$543,690 in 2020 in overstated expenses on the RCS statements due to:

- Unallowable use of estimates
- Insufficient support
- Reconciliation, calculation, and keying errors
- Duplicated costs
- Unallowable expenses
- Improper cutoff
- Foreign currency translation issues

OIG Audit offered recommendations to NGA, which, if implemented, will:

- Mitigate the risk of errors caused by manual preparation
- Ensure only actual allowable costs are reported on the RCS statements
- Prevent incurred costs from disallowance due to insufficient support

Additionally, for the selected information security requirement, OIG Audit determined that NGA did not have adequate controls in place to ensure compliance. OIG Audit offered a recommendation to NGA, which, if implemented, will mitigate the risk of noncompliance with the selected information security requirement.

For instances of noncompliance identified in this audit report, HHSC may consider tailored contractual remedies to compel NGA to meet federal, state, and contractual requirements.

Appendix A: Detailed Methodology

To gain an understanding of the methodology and data used to populate the RCS statements, OIG Audit obtained the workbooks containing the general ledger data and calculations supporting each caption on the RCS statements for 2019 and 2020. OIG Audit traced all significant formulas and calculations to identify any errors in calculations used to populate the RCS statements.

Additionally, since the Data Center caption on the RCS statements was populated based on an allocation of corporate cost pools of expenses, OIG Audit obtained the workbooks supporting the allocations for 2019 and 2020. OIG Audit traced all significant formulas and calculations to identify any errors in calculations used to determine the amounts allocated to each RCS statement. Additionally, auditors reviewed the allocation methodology for appropriateness.

To perform testing of the validity, accuracy, and allowability of costs included in the RCS statements, OIG Audit selected a non-statistical, risk-based sample of transactions for detail testing. These sample designs were chosen to address specific risk factors identified in the populations. The sample items were generally not representative of the populations for the entities; therefore, it would not be appropriate to project the test results to those populations. Sample sizes and amounts selected for testing of individual RCS statement captions in 2019 are detailed in Table A.1.

Table A.1: Detail Testing Sample Sizes in 2019

Caption	Number of Selected Transactions	Selected Amount
Salaries and Consultants	25	\$ 47,861
Fringe Benefits ²²	10	1,429,634
Data Center ²²	25	2,100,071
Security	2	12,981
G&A Partners	12	1,171,781
Office Rent, including leasehold improvements and lease pass-through expenses	12	487,323
General Upkeep and Maintenance Estimates	12	291,595

Source: OIG Audit

²² Fringe Benefits and Data Center costs represent the incurred cost within a cost pool that is allocated to HHSC. The total cost pool for fringe benefits was \$5,574,639 in 2019. The total cost pool for data center costs was \$19,204,053 in 2019.

Sample sizes and amounts selected for testing of individual RCS statement captions in 2020 are detailed in Table A.2.

Table A.2: Detail Testing Sample Sizes in 2020

Caption	Number of Selected Transactions	Selected Amount
Salaries and Consultants	25	\$ 46,663
Fringe Benefits ²³	10	351,970
Data Center ²³	35	1,488,966
Security	2	8,824
G&A Partners ²⁴	13	1,294,873
Office Rent, including leasehold improvements and lease pass-through expenses	13	563,453
General Upkeep and Maintenance Estimates	13	330,255

Source: *OIG Audit*

As fringe benefits were reported on the RCS statements based on a rate per employee, OIG Audit also obtained evidence of the employee head counts used to develop the rates.

OIG Audit adjusted the total cost pool amounts resulting from errors identified in calculations and unallowable costs for 2019 and 2020 and applied the adjusted amount to the allocation methodology to calculate the revised data center cost on the RCS statements.

For Subcontractor expenses, Security, Office Rent, and General Upkeep and Maintenance, OIG Audit agreed monthly or other applicable rates for costs reported on the RCS statements to contracts and obtained evidence of costs incurred if the contracted rates varied from the reported costs.

OIG Audit assessed the reliability of NGA's data by (a) performing electronic testing of required data elements, (b) reviewing existing information about the data and the system that produced them, and (c) interviewing agency officials knowledgeable about the data. In addition, OIG Audit traced a risk-based sample of data to source documents. After resolving the errors identified in our assessment, OIG Audit determined that the data were sufficiently reliable for the purposes of this audit.

²³ Fringe Benefits and Data Center costs represent the incurred cost within a cost pool that is allocated to HHSC. The total cost pool for fringe benefits was \$3,262,005 in 2020. The total cost pool for data center costs was \$15,968,599 in 2020.

²⁴ NGA subcontracts with G&A Partners to receive human resources outsourcing services. The costs incurred for G&A Partners services are reported as a separate caption on the RCS statements.

OIG Audit also reviewed NGA's system of internal controls, including components of internal control,²⁵ within the context of the audit objectives.

Upon completion of testing, OIG Audit calculated the adjusted amounts for indirect costs and administrative fees to determine the amount of funds due back to HHSC for each contract year, if any.

²⁵ For more information on the components of internal control, see the United States Government Accountability Office's *Standards for Internal Control in the Federal Government*, (Sept. 2014), <https://www.gao.gov/assets/gao-14-704g.pdf> (accessed Apr. 16, 2021).

Appendix B: Detailed RCS Statements

The original submission of the 2019 RCS statement and the adjusted statement that reflects the OIG Audit adjustments and calculation of the revised allowable indirect cost and administrative fee amounts are presented in Table B.1.

Table B.1: Detailed Unadjusted and Adjusted 2019 RCS Statements

Expense Category	Unadjusted	Adjustments	Final Adjusted	Associated Issue
Non-Pass-Through Expenses				
Direct Labor				
Salaries	\$ 2,917,457	(\$ 8,819)	\$ 2,908,638	1.1
Fringe Benefits	1,312,931	(29,517)	1,283,414	1.1
Total Direct Labor	4,230,388	(38,336)	4,192,052	
Other Direct Expenses				
Subcontractors				
G&A Partners	1,171,781		1,171,781	
Skillssoft	110,505		110,505	
Convergys/Pose Corporation	44,016		44,016	
IBM Corporation	5,129		5,129	
Network Support				
Data Center	2,120,328	(227,974)	1,892,354	1.2
Interactive Voice Response	18,000		18,000	
Security	190,201		190,201	
Bond Insurance	10,483		10,483	
Total Direct Expenses – Round Rock	7,900,831	(266,310)	7,634,521	
Direct Expenses – Non-Round Rock	417,512		417,512	
Indirect Expenses				
Indirect Expenses – Round Rock (15.8%)	1,248,331	(42,077)	1,206,254	
Indirect Expenses – Non-Round Rock (6.6%)	27,556		27,556	
Total Indirect Expenses	1,275,887	(42,077)	1,233,810	
Total Direct and Indirect Expenses	9,594,230	(308,387)	9,285,843	
Administrative Service Fee (20%)	1,918,846	(61,677)	1,857,169	
Pass-Through Expenses				
Postage / Delivery	20,564		20,564	
Software Licenses Fees	62,736		62,736	
Office Rent	487,323		487,323	
General Upkeep & Maintenance	291,595		291,595	
Utilities	42,936		42,936	
Printing	14,954		14,954	
All Telecommunications Lines	26,217		26,217	
Total Pass-Through Expenses	946,325		946,325	
Total Expenses	12,459,401	(370,064)	12,089,337	
Fee Ceiling				
Fixed Pricing Components	2,234,051		2,234,051	
Variable Pricing Components	9,644,373		9,644,373	
Total Fee Ceiling	11,878,424		11,878,424	
Lesser of Total Expenses and Total Fee Ceiling	11,878,424		11,878,424	
Less: Total Previously Billed to and Paid by HHSC	11,878,424		11,878,424	
Amount Due To (From) NGA	—		—	

Source: NGA, HHSC, and OIG Audit

The original submission of the 2020 RCS statement and the adjusted statement that reflects the OIG Audit adjustments and calculation of the revised allowable indirect cost and administrative fee amounts are presented in Table B.1.

Table B.2: Detailed Unadjusted and Adjusted 2020 RCS Statements

Expense Category	Unadjusted	Adjustments	Final Adjusted	Associated Issue
Non-Pass-Through Expenses				
Direct Labor				
Salaries	\$ 3,843,471		\$ 3,843,471	1.1
Fringe Benefits	1,253,771	(\$ 58,491)	1,195,280	1.1
Total Direct Labor	5,097,242		5,038,751	
Other Direct Expenses				
Subcontractors				
G&A Partners	1,294,873		1,294,873	
Skillsoft	145,695		145,695	
Convergys/Pose Corporation	47,684		47,684	
IBM Corporation	5,610		5,610	
Network Support				
Data Center	2,195,719	(332,765)	1,862,954	1.2
Interactive Voice Response	19,500		19,500	
Security	208,381		208,381	
Bond Insurance	10,483		10,483	
Total Direct Expenses – Round Rock	9,025,187	(391,256)	8,633,931	
Direct Expenses – Non-Round Rock	252,398		252,398	
Indirect Expenses				
Indirect Expenses – Round Rock (15.8%)	1,425,980	(61,819)	1,364,161	
Indirect Expenses – Non-Round Rock (6.6%)	16,658		16,658	
Total Indirect Expenses	1,442,638	(61,819)	1,380,819	
Total Direct and Indirect Expenses	10,720,223	(453,075)	10,267,148	
Administrative Service Fee (20%)	2,144,045	(90,615)	2,053,430	
Pass-Through Expenses				
Postage / Delivery	12,258		12,258	
Software Licenses Fees	101,411		101,411	
Office Rent	563,453		563,453	
General Upkeep & Maintenance	330,255		330,255	
Utilities	48,364		48,364	
Printing	17,489		17,489	
All Telecommunications Lines	24,516		24,516	
Total Pass-Through Expenses	1,097,746		1,097,746	
Total Expenses	13,962,014	(543,690)	13,418,324	
Fee Ceiling				
Fixed Pricing Components	2,447,623		2,447,623	
Variable Pricing Components	10,810,290		10,810,290	
Total Fee Ceiling	13,257,913		13,257,913	
Lesser of Total Expenses and Total Fee Ceiling	13,257,913		13,257,913	
Less: Total Previously Billed to and Paid by HHSC	13,257,913		13,257,913	
Amount Due To (From) NGA	—		—	

Source: NGA, HHSC, and OIG Audit

Appendix C: Acronyms and Abbreviations

Acronyms Used in This Report

GAAP	Generally accepted accounting principles
HHS	Health and Human Services
HHSC	Health and Human Services Commission
OIG	Office of Inspector General
OIG Audit	OIG Audit and Inspections Division
NGA	NorthgateArinso, Inc.
RCS	Retrospective Cost Settlement
RFP	Request for Proposals

Appendix D: Report Team and Distribution

Report Team

OIG staff members who contributed to this audit report include:

- Audrey O’Neill, CIA, CFE, CGAP, Chief of Audit and Inspections
- Kacy J. VerColen, CPA, Deputy Inspector General of Audit and Inspections
- Anton Dutchover, CPA, Audit Director
- Amy Adler, CPA, CFE, Senior Managing Auditor & Audit Project Manager
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- Victoria Ford, Chief Policy and Regulatory Officer
- Karen Ray, Chief Counsel
- Michelle Alletto, Chief Program and Services Officer
- Nicole Guerrero, Director of Internal Audit

NorthgateArinso, Inc.

- Leslie Cruz, Senior Director, Account and Site Operations

Appendix E: OIG Mission, Leadership, and Contact Information

The mission of OIG is to prevent, detect, and deter fraud, waste, and abuse through the audit, investigation, and inspection of federal and state taxpayer dollars used in the provision and delivery of health and human services in Texas. The senior leadership guiding the fulfillment of OIG's mission and statutory responsibility includes:

- Sylvia Hernandez Kauffman, Inspector General
- Susan Biles, Chief of Staff
- Dirk Johnson, Chief Counsel
- Christine Maldonado, Chief of Operations and Workforce Leadership
- Juliet Charron, Chief of Strategy
- Steve Johnson, Chief of Investigations and Reviews

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