

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**SOUTHEASTERN TIDEWATER
OPPORTUNITY PROJECT, INC., HEAD
START PROGRAM CLAIMED
UNALLOWABLE COSTS FOR GRANT
YEAR APRIL 1, 2010, THROUGH
MARCH 31, 2011**

*Inquiries about this report may be addressed to the Office of Public Affairs at
Public.Affairs@oig.hhs.gov.*



Stephen Virbitsky
Regional Inspector General

February 2013
A-03-11-00501

Office of Inspector General

<https://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

EXECUTIVE SUMMARY

BACKGROUND

Head Start is a national program that provides grants to local public and private nonprofit and for-profit agencies to provide comprehensive child development services to economically disadvantaged children and families. Head Start programs focus on helping preschoolers develop the early reading and math skills needed to be successful in school. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF), Office of Head Start, administers the Head Start program.

The American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, provided an additional \$1 billion for the Head Start program during fiscal years 2009 and 2010. These funds were intended for activities such as expanding enrollment, funding cost-of-living wage increases for grantees, upgrading centers and classrooms, and bolstering training and technical assistance.

The Southeastern Tidewater Opportunity Project, Inc. (STOP), a nonprofit organization, was created in 1965. STOP had Head Start classrooms in 34 locations to serve approximately 1,500 economically disadvantaged preschool children. For the audited grant year (April 1, 2010, through March 31, 2011), ACF awarded \$11,594,065 to the STOP Head Start program, which accounted for 80 percent of STOP's Head Start budget. The remaining 20 percent of STOP's budget consisted of in-kind contributions of goods and services. In addition, the STOP Head Start program received \$769,066 in Recovery Act grant funding for the period June 1, 2009, through September 30, 2010.

On February 26, 2011, a month before the end of the grant year, STOP relinquished its Head Start program due to insolvency. Accordingly, the Office of Head Start requested that we audit the STOP Head Start program.

OBJECTIVE

Our objective was to determine whether costs claimed by STOP were allowable under the terms of its grants and applicable Federal laws and regulations.

SUMMARY OF FINDINGS

Of the \$11,594,065 that STOP claimed under its Head Start grant, \$10,867,319 was allowable. STOP recorded unallowable expenditures totaling \$949,399: \$807,861 for costs incurred prior to the award period, \$120,161 for improperly allocated fringe benefit costs, \$15,768 for costs that were not supported by source documentation, and \$5,609 in duplicate costs. However, because its total recorded Head Start expenditures exceeded the amount of the Head Start grant by \$222,653, only \$726,746 of the unallowable expenditures was reimbursed by the Federal Government. The \$203,238 that STOP claimed under a separate Recovery Act grant was allowable.

Because of deficiencies in financial management and financial governance, STOP used Head Start funds from the grant period we examined to pay for expenditures incurred in prior grant periods and, in some cases, for expenditures incurred by other programs. As a result, STOP

exceeded its available funding for its Head Start program, became insolvent, and had to relinquish its program.

RECOMMENDATION

We recommend that ACF require STOP to refund to the Federal Government \$726,746 related to the Head Start grant.

SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., COMMENTS

In written comments on our draft report, STOP did not concur with our recommendation and requested that unallowable costs be reduced by allowable costs it had not claimed. STOP provided additional information about its accounting of Head Start funds and said that it had taken steps to improve its financial management. STOP submitted documentation for \$375,725 of “substitute and additional costs” to offset costs disallowed in the report. STOP also requested that grant closeout costs that STOP submitted to ACF be used to offset the disallowance.

OFFICE OF INSPECTOR GENERAL RESPONSE

We clarified our discussion of STOP’s financial management based on the additional information provided. We reviewed the documentation for \$375,725 of substitute and additional costs that STOP submitted to offset the disallowed costs. Of that amount, STOP had previously claimed \$277,108, which we reviewed during our audit. At that time we allowed \$275,902, and disallowed \$1,206 of these costs. Because STOP provided a receipt supporting \$1,206 that we had disallowed, we have adjusted our finding and recommendation to allow that amount as well. We did not audit STOP’s claim for the remaining \$98,617 of additional costs and offer no opinion on its validity. We also did not audit STOP’s grant closeout costs and offer no opinion on them.

We maintain the validity of our recommendation, as well as our conclusion that STOP claimed unallowable costs.

OFFICE OF HEAD START COMMENTS

In written comments on our draft report, the Office of Head Start concurred with our findings and recommendation and described the action it had taken, or planned to take, to address them.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
Head Start Program.....	1
Southeastern Tidewater Opportunity Project, Inc.....	1
OBJECTIVE, SCOPE, AND METHODOLOGY	1
Objective.....	1
Scope.....	2
Methodology.....	2
FINDINGS AND RECOMMENDATION	3
UNALLOWABLE COSTS CLAIMED	3
Prior Period Costs Claimed.....	3
Unallocable Fringe Benefit Costs Claimed.....	5
Unsupported Costs Claimed	5
Duplicate Costs Claimed.....	5
FINANCIAL MANAGEMENT	6
FINANCIAL GOVERNANCE	6
RECOMMENDATION	7
SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., COMMENTS	7
OFFICE OF INSPECTOR GENERAL RESPONSE	7
OFFICE OF HEAD START COMMENTS	7
APPENDIXES	
A: SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., SCHEDULE OF HEAD START GRANT EXPENDITURES RECORDED FOR THE PERIOD APRIL 1, 2010, THROUGH FEBRUARY 28, 2011, AND RESULTS OF AUDIT	
B: SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., COMMENTS	
C: OFFICE OF HEAD START COMMENTS	

INTRODUCTION

BACKGROUND

Head Start Program

Head Start is a national program that provides grants to local public and private nonprofit and for-profit agencies to provide comprehensive child development services to economically disadvantaged children and families. Head Start programs focus on helping preschoolers develop the early reading and math skills needed to be successful in school. Head Start programs engage parents in their children's learning and emphasize parental involvement in the administration of local Head Start programs. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF), Office of Head Start, administers the Head Start program.

The American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, provided an additional \$1 billion for the Head Start program during fiscal years 2009 and 2010. These funds were intended for activities such as expanding enrollment, funding cost-of-living wage increases for grantees, upgrading centers and classrooms, and bolstering training and technical assistance.

Southeastern Tidewater Opportunity Project, Inc.

The Southeastern Tidewater Opportunity Project, Inc. (STOP), a nonprofit organization created in 1965, was governed by a 25-member volunteer Board of Directors (Board) consisting of area residents, business and civic leaders, and elected officials or their designees. STOP had Head Start classrooms in 34 locations to serve approximately 1,500 economically disadvantaged preschool children.

For the audited grant year (April 1, 2010, through March 31, 2011), ACF awarded \$11,594,065 to the STOP Head Start program, which accounted for 80 percent of STOP's Head Start budget. The remaining 20 percent of STOP's budget consisted of in-kind contributions of goods and services. In addition, the STOP Head Start program received \$769,066 in Recovery Act grant funding for the period June 1, 2009, through September 30, 2010.

On February 26, 2011, a month before the end of the audited grant year, STOP relinquished its Head Start program due to insolvency. On February 28, 2011, the Office of Head Start appointed the Community Development Institute as interim grantee to avoid an interruption of services in the Head Start program.

ACF requested that we perform this review. The report is intended for use by the Grants Officer to assist in closing out the grant.

OBJECTIVE, SCOPE AND METHODOLOGY

Objective

Our objective was to determine whether costs claimed by STOP were allowable under the terms of its grants and applicable Federal laws and regulations.

Scope

We reviewed the STOP Head Start program's recorded expenditures and financial governance for the period April 1, 2010, through February 28, 2011. During that period, STOP recorded expenditures totaling \$11,816,718 for the regular grant, but was able to claim reimbursement only for \$11,594,065 (the amount of the award). We also reviewed \$203,238 in Recovery Act funds that STOP's Head Start program claimed during the audit period.

STOP's grant closeout costs were outside the scope of our audit. Because STOP relinquished the Head Start program due to insolvency, we did not perform an overall assessment of the STOP Head Start program's internal control structure.

We performed our fieldwork at the STOP administrative offices in Norfolk, Virginia, and at its independent auditor's office in Roanoke, Virginia, from June through September 2011.

Methodology

To accomplish our objective, we:

- reviewed relevant Federal laws, regulations, and guidance;
- compared approved budgeted costs to actual costs to identify variances contributing to STOP's insolvency;
- reviewed the workpapers and the Office of Management and Budget (OMB) Circular A-133 audit report for the year ended June 2010 and the subsequent revised report expressing an adverse opinion for the same year;
- analyzed source documentation to determine the allowability of salaries, fringe benefits, supplies and other costs recorded during the audit period;
- reviewed journal entries to identify period-end adjustments;
- verified that STOP's drawdowns did not exceed the Federal drawdown limits;
- reviewed the available minutes of the Board meetings for the period April 1, 2010, through March 31, 2011, to evaluate the Board's monitoring of STOP's fiscal performance;
- interviewed current and former members of STOP's financial management team and the chairman of the Board to gain an understanding of STOP's policies, procedures, and internal controls relating to financial management; and
- interviewed Office of Head Start staff responsible for monitoring the STOP Head Start program.

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 objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATION

Of the \$11,594,065 that STOP claimed under its Head Start grant, \$10,867,319 was allowable. STOP recorded unallowable expenditures totaling \$949,399: \$807,861 for costs incurred prior to the award period, \$120,161 for improperly allocated fringe benefit costs, \$15,768 for costs that were not supported by source documentation, and \$5,609 in duplicate costs. However, because its total recorded Head Start expenditures exceeded the amount of the Head Start grant by \$222,653, only \$726,746 of unallowable expenditures was reimbursed by the Federal Government. The \$203,238 that STOP claimed under a separate Recovery Act grant was allowable.

Because of deficiencies in financial management and financial governance, STOP used Head Start funds from the grant period we examined to pay for expenditures incurred in prior grant periods and, in some cases, for expenditures incurred by other programs. As a result, STOP exceeded its available funding for its Head Start program, became insolvent, and had to relinquish its program.

UNALLOWABLE COSTS CLAIMED

STOP recorded unallowable expenditures totaling \$949,399: \$807,861 for costs incurred prior to the award period, \$120,161 for improperly allocated fringe benefit costs, \$15,768 for costs that were not supported by source documentation, and \$5,609 in duplicate payments.

Prior Period Costs Claimed

Federal administrative requirements (45 CFR § 74.28) state that "[w]here a funding period is specified, a grantee may charge only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the HHS awarding agency"¹ Head Start further clarifies that:

Grantee agencies are not allowed to obligate more grant funds in one year than they were actually awarded, with the expectation of paying the excess amount with the following year's Head Start grant funds. If a grantee agency does obligate itself for more debt than it has grant funds to cover, then the grantee must use agency funds or sources of funding to pay the excess. They may not use Head Start grant funds.²

Prior Period Salaries and Wages

STOP recorded two transactions for salaries and wages that were unallowable because the costs were incurred in the grant year ended March 31, 2010. On June 30, 2010, STOP transferred \$381,371 in salaries for food services staff from a United States Department of Agriculture

¹ The Office of Head Start did not authorize any pre-award costs for the audited grant year.

² Head Start, "Obligation and Expenditure of Funds," accessed at <http://eclkc.ohs.acf.hhs.gov> on February 15, 2013.

(USDA) food grant to the Head Start grant covering the period April 1, 2010, to March 30, 2011. Food service staff salaries are an allowable Head Start cost; however, only \$70,656 was incurred during the audited grant year. The remaining \$310,715 was incurred during the prior grant year (April 1, 2009, to March 31, 2010). STOP transferred these costs to the Head Start program grant because its costs under the USDA grant award exceeded the amount of the award.

Also on June 30, 2010, STOP improperly transferred to the audited grant year \$194,807 in salaries related to certain quality initiatives payable in the prior grant year.

Prior Period Fringe Benefits Costs

STOP recorded two transactions that effectively moved fringe benefit costs incurred in the grant year ended March 31, 2010, to the audited grant year.

On April 1, 2010, STOP transferred to the audited grant year \$122,020 in unallowable prior-year costs. Because its Head Start program was on summer break during July and August 2010, STOP included pro-rated portions of July and August 2010 health and dental insurance premiums in the premium payments that it made throughout the ten-month school year. From the beginning of the school year (September 2009) through the end of the prior grant period (March 2010), STOP recorded \$1,250,215 in expenditures for health and dental premiums. On April 1, 2010, the first day of the audited grant year, STOP transferred \$330,431 to the grant. According to a former STOP official,³ this amount represented the portion of July and August health and dental insurance premiums paid between September 2009 and March 2010. Costs allocable to the audited grant year are allowable. However, STOP did not provide any details for how it calculated the portion of July and August premiums. Based on our calculation, the pro-rated portion of July and August premiums should have been \$208,411 ($\$1,250,215 \times 16.67$ percent⁴). Therefore, we concluded that \$122,020 of the \$330,431 that STOP transferred to the grant on April 1, 2010, was unallowable.

On June 30, 2010, STOP recorded expenditures of \$163,444 that included \$152,052 for various other fringe benefit costs incurred prior to the audited grant year.

Prior Period "Other" Costs

In April and May of 2010, STOP charged to the audited grant year \$27,482 for other costs that were unallowable because the costs were incurred from January through March 2010, during the prior grant year. These unallowable costs involved 42 invoices from 27 vendors and thus were not isolated errors. For example, on April 14, 2010, STOP recorded a \$118 expenditure for telephone costs incurred for February 2010, prior to the start of the audited grant year.

Prior Period Costs for Supplies

STOP charged three transactions for supplies totaling \$785 that were unallowable because the costs were incurred in the prior grant year. For example, on April 14, 2010, STOP charged to the

³ Because the Head Start program had been discontinued, most officials involved in the program were no longer employed by STOP.

⁴ This percentage reflects $2/12^{\text{th}}$ of the recorded premiums, the prorated amount required in each month of the school year to prepay the July and August premiums.

grant \$574 to replace two Head Start laser jet printers that shipped and invoiced in March 2010, prior to the audited grant year.

Unallocable Fringe Benefit Costs Claimed

Federal cost principles (2 CFR part 230, App. A, § A.2.a⁵) require that to be an allowable cost under an award, a cost must be reasonable for the performance of the award and allocable to the award. Further, a cost is “allocable to a particular cost objective ... in accordance with the relative benefits received” (2 CFR part 230, App. A, § A.4.a). In addition, “[a]ny cost allocable to a particular award ... may not be shifted to other Federal awards to overcome funding deficiencies....” (2 CFR part 230, App. A., § A.4.b).

STOP claimed \$120,161 in unallowable health and dental insurance premiums for July and August 2011. Because the Head Start program did not operate during July and August, STOP included a portion of the health and dental insurance premiums for those months in its expenditures for premiums recorded during the ten-month school year. From September 2010 through February 2011, STOP recorded expenditures totaling \$720,823 for health and dental insurance that included prepayments for a portion of the premiums for July and August 2011, which fell after the end of the audited grant year.

When STOP relinquished the Head Start program due to insolvency, it should have recorded an adjustment to decrease its expenditures for health and dental insurance premiums by the amount of the prepayments for July and August 2011. However, STOP did not calculate the portion of expenditures for health and dental insurance that were prepaid for the July and August premiums. We estimated the unallowable costs as 16.67 percent⁶ of the expenditures for health and dental premiums recorded between September 2010 and February 2011. Based on our calculation, \$120,161 (\$720,823 x 16.67 percent) was unallowable because it represented costs incurred for a period that was not covered by the grant.

Unsupported Costs Claimed

Federal cost principles (2 CFR part 230, App. A, § A.2.g) require that costs be adequately documented to be allowable under an award. Grantees’ financial management systems must provide for accounting records, including cost accounting records, that are supported by source documentation (45 CFR § 74.21(b)(7)).

STOP did not provide adequate source documentation to support 12 transactions totaling \$15,768 for various “Other” claimed costs. These transactions related to invoices from 11 vendors and thus were not isolated errors.

Duplicate Costs Claimed

Federal cost principles (2 CFR part 230, App. A, § A.2) state that, to be allowable under an award, costs must be reasonable for the performance of the award. A cost is reasonable if, in its

⁵ OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, was relocated to 2 CFR part 230.

⁶ This percentage reflects 2/12^{ths} of the recorded premiums, the prorated amount required in each month of the school year to prepay the July and August premiums.

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 costs (2 CFR part 230, App. A, § A.3).

STOP claimed duplicate costs totaling \$5,609: \$3,806 for an invoice for dental coverage paid on two separate occasions and \$1,803 for an invoice for security services paid on two separate occasions. During the audit, we informed STOP of the duplicate payments. STOP agreed to contact the vendors to request refunds of the duplicate payments.

FINANCIAL MANAGEMENT

Federal standards for financial management systems (45 CFR § 74.21(b)(3)) require that recipients' financial management systems provide for effective control over and accountability for all funds, property and other assets.

STOP's financial management system did not provide for effective control over and accountability for Head Start funds awarded for the audited grant year. We found that, when costs exceeded available funding for other, non-Head Start programs, STOP used funding from the Head Start program to cover those costs until appropriate funds could be obtained. For example, STOP maintained a joint bank account for Head Start and Community Economic Development grants and had a procedure that identified grant funds by award number in the accounting system. However, documentation showed that on April 23, 2010, STOP used \$133,000 of Head Start funds from the account to cover Community Economic Development program costs until April 26, 2010, when funds could be drawn down from the Community Economic Development program grant. A former STOP official said that STOP transferred or "moved" expenditures from grant year to grant year and from program to program to manage cash flows.

Because STOP used the Head Start grant funds to pay costs of other grant years and other programs, its expenditures exceeded the available funding for its Head Start program and STOP had to relinquish its program.

FINANCIAL GOVERNANCE

Section 642(c) of the Head Start Act requires that grantees establish and maintain a formal structure for program governance, including a governing body with legal and fiscal responsibility for administering and overseeing the Head Start agency, including the safeguarding of Federal funds. The governing body is responsible for reviewing financial audits and the grantee's progress in carrying out the programmatic and fiscal responsibilities described in the grant application. Section 642 (d)(2) requires grantees to ensure the sharing of accurate and regular information, including monthly financial statements and the financial audit, for use by the governing body.

STOP's Board did not adequately monitor financial management practices. The chairman of the finance committee⁷ stated he had shredded all of the minutes of the finance committee meetings generated during the grant term. As a result, the Board lacked evidence of its financial governance. However, the Board took no action to prevent STOP from using funds from the

⁷ The chairman left the board when STOP relinquished its program.

grant year beginning April 1, 2010, to pay for expenses related to the prior year grant or to cover costs for unrelated programs.

The approved minutes of the Board meetings included monthly Overview Summary Expenditure Reports that reflected overspending of the Head Start grant. However, the minutes did not show any actions by the Board to safeguard against the overspending of the authorized budget included in the terms of the awarded Head Start grant for the year ended March 31, 2011. By the end of February 2011, a month before grant yearend, STOP had overspent its authorized budget by \$222,653 and could not continue operations.

RECOMMENDATION

We recommend that ACF require STOP to refund to the Federal Government \$726,746 related to the Head Start grant.

SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., COMMENTS

In written comments on our draft report, STOP did not concur with our recommendation and requested that unallowable costs be reduced by allowable costs it had not claimed. STOP provided additional information about its accounting of Head Start funds and said that it had taken steps to improve its financial management. STOP submitted documentation for \$375,725 of “substitute and additional costs” to offset costs disallowed in the report. STOP also requested that grant closeout costs that STOP submitted to ACF be used to offset the disallowance.

STOP’s comments are included as Appendix B. We redacted STOP’s comments and did not include the attachments accompanying them because they contained confidential financial information.

OFFICE OF INSPECTOR GENERAL RESPONSE

We clarified our discussion of STOP’s financial management based on the additional information provided. We reviewed the documentation for \$375,725 of substitute and additional costs that STOP submitted to offset the disallowed costs. Of that amount, STOP had previously claimed \$277,108, which we reviewed during our audit. At that time we allowed \$275,902, and disallowed \$1,206 of these costs. Because STOP provided a receipt supporting \$1,206 that we had disallowed, we have adjusted our finding and recommendation to allow that amount as well. We did not audit STOP’s claim for the remaining \$98,617 of additional costs and offer no opinion on its validity. We also did not audit STOP’s grant closeout costs and offer no opinion on them.

We maintain the validity of our recommendation, as well as our conclusion that STOP claimed unallowable costs.

OFFICE OF HEAD START COMMENTS

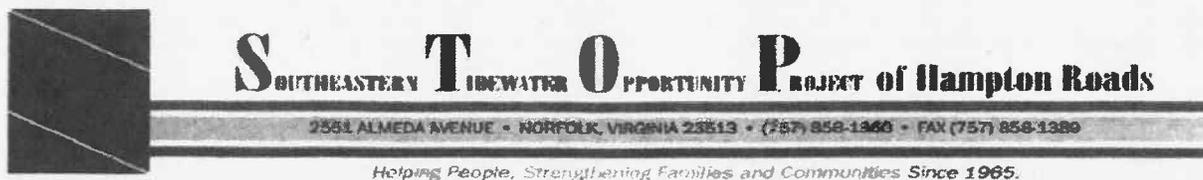
In written comments on our draft report, the Office of Head Start concurred with our findings and recommendation and described the action it had taken, or planned to take, to address them. The Office of Head Start’s comments are included in their entirety as Appendix C.

APPENDIXES

**APPENDIX A: SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC.,
SCHEDULE OF HEAD START GRANT EXPENDITURES RECORDED
FOR THE PERIOD APRIL 1, 2010, THROUGH FEBRUARY 28, 2011,
AND RESULTS OF AUDIT**

Budgetary Category	Awarded	Recorded	Unallowable	Allowable
Salaries	\$6,422,825	\$6,108,839	\$505,522	\$5,603,317
Fringe	2,690,376	2,886,131	398,039	2,488,092
Benefits				
Supplies	143,420	90,165	785	89,380
Other	<u>2,337,444</u>	<u>2,731,583</u>	<u>45,053</u>	<u>2,686,530</u>
Subtotal	\$11,594,065	\$11,816,718	\$949,399	\$10,867,319
Expenditures Exceeding Awarded			(-222,653)	
Totals	\$11,594,065	\$11,816,718	\$726,746	\$10,867,319

APPENDIX B: SOUTHEASTERN TIDEWATER OPPORTUNITY PROJECT, INC., COMMENTS



OFFICIAL RESPONSE TO DRAFT REPORT FROM U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES,
OFFICE OF INSPECTOR GENERAL (REPORT NUMBER A-03-11-00501)

ORGANIZATIONAL PROFILE

The STOP Organization-Hampton Roads (STOP) is a 501 (c) (3) non-profit community action agency operating in South Hampton Roads for more than 47 years. STOP operates several programs and services and currently has over 50 employees. Over the past 47 years, STOP has been at the forefront of providing support and capacity enhancement for individuals and families throughout South Hampton Roads. As a result of some major previous leadership issues and financial challenges, STOP voluntarily relinquished its Head Start program effective March 1, 2011 and is currently in the process of reconstituting itself under new administrative leadership and improved Board governance and oversight. The STOP Board of Directors, at its regular meeting held on Tuesday, July 17, 2012, approved and authorized the submission of the following response to the draft OIG audit report:

Respectfully submitted and mailed, via Federal Express, on August 1, 2012

George F. Reed
George F. Reed, Chairman
STOP Board of Directors

Regina P. Lawrence
Regina P. Lawrence
President and CEO

The Department of Health and Human Services' Office of Inspector General (OIG) is recommending, in its draft audit report, "that ACF require STOP to refund the Federal Government \$727,952 related to the Head Start grant."

For the reasons stated below, STOP does not concur with the recommendation and also requests any expenditures found to be unallowable be reduced by the amount of allowable costs incurred by STOP; all for which it did not claim Federal funding.

Section I: STATEMENT OF NON-CONCURRENCE

We are in receipt of your email correspondence dated June 29, 2012 and the attached draft report detailing the claimed unallowable cost. After reviewing this report and based upon the instructions contained therein, The STOP Board of Directors, President and CEO and Financial Staff **do not concur** with the information reported on page 6, under the Section entitled, Financial Management which reads, "We found that when cost exceeded available funding for a program, STOP transferred expenses to other program. For example, documentation showed that on April 23, 2010, STOP transferred \$133,000 from a Head Start account to cover excess cost for a community economic development program. STOP anticipated no further funding for the community economic development program. A former STOP official said that STOP transferred or "moved" expenditures from grant year to grant year and from program to program to manage cash flows. Because STOP used the Head Start grant funds to pay cost of other grant years and other programs, its expenditures exceeded the available funding for its Head Start program and STOP had to relinquish its program."

STOP Response - August 1, 2012
OIG Draft Audit Report No. A-03-11-00501

Response: Reason for Non-Concurrence

STOP was awarded a three-year (September 30, 2009-September 29, 2012), Community Economic Development (CED) Grant by the U. S. Department of Health and Human Services (HHS) in the amount of \$574,800. A total of \$ 422,000 of the grant funds were expended in 2010 with the remaining \$152,800 expended in 2011. The third year of the grant was un-funded and structured to attain financial sustainability. Based upon the financial reconciliation of the CED grant conducted by the current Finance Department staff in February 2012, it was determined that the bank withdrawal in question totaling \$133,000 was an amount allocated specifically to pay for CED expenditures. Direct disbursement check number [REDACTED] dated April 23, 2010, in the amount of \$133,000, made payable to "STOP Disbursing Account" is included in the reconciliation as a deposit into STOP's Main Operating Account. This particular check does not specifically denote the CED grant for which payment was made; however, **the source documentation is provided as Attachment 1.**

The original bank account was established for Head Start; however, when STOP was awarded the CED grant, which was also funded by HHS, the CED grant dollars were deposited into the existing account originally designated for Head Start. The funding source was the same for Head Start and CED and they both shared the same bank account.

Although the bank account was the same, each grant had a distinctive award number which identified account activity. It was established by the current Finance Staff that all the dollars which were drawn from the one account, with the distinctive grant award number for CED activity, total the amount of the CED grant award dollars which includes the \$133,000 in question.

The process previously used to cover Head Start and CED expenditures from the STOP/HHS bank account, which housed both the Head Start and CED grant dollars, was as follows:

- (1) Disbursement checks, for either Head Start or CED, were made payable to STOP and were processed from the STOP/HHS bank account for the applicable grant
- (2) STOP deposited the checks into the STOP Main Operating Account
- (3) Checks were processed from STOP's Main Operating Account to cover expenditures incurred by either Head Start or CED, as designated by distinctive award number

Statement of Alternative Action Taken or Planned

Effective March 31, 2011, STOP's current President and CEO terminated the employment of individuals previously associated with the Finance Department.

All Finance and Administrative staff are now required to attend, at minimum, annual financial management training for non-profits from reputable trainers to include Chief Financial Officers from "sister" Community Action Agencies (CAA's). STOP's President and CEO requested initial training and technical assistance for STOP's Finance staff from two well respected CAA's within

STOP Response - August 1, 2012
 OIG Draft Audit Report No. A-03-11-00501

the State. The Chief Financial Officers from these agencies agreed to provide initial training to STOP's Finance staff. The Administrator for Financial Services and the primary Accountant have both participated in numerous webinars and trainings regarding "best practices" in the financial management of non-profits.

From October 2011 through January 2012, with a grant received from the Virginia Association of Community Action Programs (VACAP), STOP received in-depth, on-site financial management training and technical assistance from a Financial Consultant who is one of the most well respected Chief Financial Officers in Virginia's network of community action agencies.

The STOP Board of Directors met on January 24, 2012 and based upon STOP's continuing need, the President and CEO requested and received a "vote of confidence" from the Board to continue the utilization of the Financial Consultant's services as our "Remote Chief Financial Officer" for a period of six (6) months. The Financial Consultant is a highly qualified Certified Public Accountant contracted to not only reconcile all financial activities throughout the entire Agency but to continue to train the Finance Department staff. Additionally, a new database is currently being created to maximize the efficiency of the agency's overall financial management process.

Section II: SUBSTITUTE COST REQUEST

STOP respectfully requests that the disallowed costs be reduced by the amount of Head Start expenses incurred during the grant year, but were paid after March 1, 2011 with STOP's own funds. We are requesting that we be allowed to substitute unallowable costs with allowable costs for which we did not claim federal funding. Consideration is requested and source documentation is herewith attached for each of the expenses listed as follows:

<u>Attachment Number/Description</u>	<u>Amount</u>	<u>Check No.</u>	<u>Date Paid/Status</u>
2. <u>First Group-Head Start Staff Payroll</u> with Federal & State Taxes for 6 days	\$ 83,711.10	Direct Deposit	7/5/11 Paid in Full
3. <u>Second Group- Head Start Staff Payroll</u> with Federal & State Taxes for 6 days	\$ 28,465.52	Direct Deposit	8/25/11 Paid in Full
4. <u>Third and Final Group- Head Start Staff Payroll</u> with Federal & State Taxes for 6 days	\$103,385.40	Direct Deposit	9/13/11 Paid in Full
Total	\$215,562.02		
Less Head Start Funds	-\$ 48, 891.45		
Amount STOP Paid	\$166,670.57		
5. <u>Virginia Employment Commission</u> First Group-Head Start Staff Payroll State Unemployment taxes for 6 days	\$ 36,000.00		11/3/11 Partial Payment

STOP Response - August 1, 2012
 OIG Draft Audit Report No. A-03-11-00501

6.	<u>Virginia Employment Commission</u> Second Group-Head Start Staff Payroll State Unemployment taxes for 6 days	\$ 750.00	██████████	12/8/11 Partial Payment
7.	<u>Virginia Employment Commission</u> Third Group- Head Start Staff Payroll State Unemployment taxes for 6 days	\$ 750.00	██████████	1/8/12 Partial Payment
8.	<u>Virginia Employment Commission</u> Fourth and Final Head Start Staff Payroll State Unemployment Taxes, with interest, for 6 days	\$ 99,820.64	Bank Draft	3/1/12 Paid in Full
9.	██████████ Initial Payment - Head Start Portion of Agency-Wide Audit Fees	\$ 3,808.02	██████████	12/28/11 Partial Payment
10.	██████████ Second Payment - Head Start Portion of Agency-Wide Audit Fees	\$ 3,808.02	██████████	1/13/12 Partial Payment
11.	██████████ Final Payment - Head Start Portion of Agency-Wide Audit Fees	\$ 3,758.20	██████████	1/13/12 Final Payment
12.	██████████ Initial Payment - Head Start Invoice for Services Rendered To Audit STOP's 2010 Pension Plan	\$ 926.40	██████████	1/28/11 Partial Payment
13.	██████████ Final Payment - Head Start Invoice for Services Rendered To Audit STOP'S 2010 Pension Plan	\$ 1,627.50	██████████	12/28/11 Final Payment
14.	██████████ First Payment - Invoice for Services Rendered to Audit STOP's 2011 Pension Plan Audit	\$ 1,860.00	██████████	7/26/12 Partial Payment

STOP Response - August 1, 2012
 OIG Draft Audit Report No. A-03-11-00501

[REDACTED] Upon receipt of the Final Invoice for Payment for Services Rendered to Audit STOP's 2011 Pension Plan. The anticipated completion date 9/17/12. Source documentation will be forwarded to the OIG upon completion.	\$ 1,627.50	9/30/12 Pending Payment
15. [REDACTED] Head Start Food Services	\$ 45,000.00 (negotiated)	\$835.00 Monthly Payment
16. <u>Final Payment to Vendors for Head Start Closeout Package</u>	\$ 1.96	[REDACTED] Final Payment
Sub-Total.....	\$366,408.81	

Section III: UNSUPPORTED COSTS CLAIMED

On page 5 of the draft audit report, it states, "STOP did not provide adequate source documentation to support 13 transactions totaling \$16,974 for various "Other" claimed costs. The transactions related to invoices from 11 vendors and thus were not isolated errors."

Response: STOP respectfully requests that the disallowed costs be reduced by \$1,205.74.

Consideration is requested and source documentation is herewith attached for this one (1) transaction as follows:

<u>Attachment Number/Description</u>	<u>Amount</u>	<u>Check No.</u>	<u>Date Paid/Status</u>
17. [REDACTED] [REDACTED]	\$ 1, 205.74	[REDACTED]	11/8/10 Paid in Full
Sub-Total.....	\$ 1,205.74		

Section IV: ADDITIONAL COSTS INCURRED

Additionally and as a direct result of STOP's financial liability incurred during the grant year and after the relinquishment of Head Start, STOP found it necessary to secure the services of a tax consultant who negotiated with the Virginia Employment Commission for the remaining balance and final payment of the State Unemployment Taxes due on behalf of former Head Start employees; the balance totaled \$99,820.64.

STOP Response - August 1, 2012
 OIG Draft Audit Report No. A-03-11-00501

<u>Attachment Number/Description</u>	<u>Amount</u>	<u>Check No.</u>	<u>Date Paid/Status</u>
18. [REDACTED], Tax <u>Consultant Fee:</u>			
Invoice Number: 00157499	\$ 1,000.00	[REDACTED]	11/1/11 Partial Payment
00157499	\$ 829.00	[REDACTED]	12/13/11 Paid in Full
00157959	\$ 1,098.50	[REDACTED]	1/12/12 Paid in Full
00158469	\$ 744.50	[REDACTED]	2/14/12 Paid in Full
00159023	\$ 2,186.75	[REDACTED]	4/5/12 Partial Payment
3909001	\$ 2,252.35	[REDACTED]	5/25/12 Paid in Full
Sub-Total.....	\$ 8,111.10		

GRAND TOTAL OF REQUEST FOR
 CONSIDERATION.....\$375,725.65

Section V: DUPLICATE COSTS CLAIMED

The current STOP Board of Directors and Administrative Staff would like to take this opportunity to sincerely thank the OIG Audit Team for the manner in which they conducted our audit as well as their assistance in directing our attention to duplicate payments described as follows on page 6 of the draft audit report: "STOP claimed duplicate costs totaling \$5,609: \$3,806 for an invoice for dental coverage paid on two separate occasions and \$1,803 for an invoice for security services paid on two separate occasions. During the audit, we informed STOP of the duplicate payments. STOP agreed to contact the vendors to request refunds of the duplicate payments."

Response: STOP is still in the process of negotiating with its former dental insurance provider regarding the outstanding balance for costs incurred during the month of February 2011. We are attempting to utilize the \$3,806, in question, as an initial payment towards the outstanding balance.

STOP did receive a check in the amount of \$1,306.83 as a refund from its security service provider. Funds received were applied towards payments of smaller debts incurred by Head Start during the grant year in question.

STOP Response - August 1, 2012
OIG Draft Audit Report No. A-03-11-00501

Upon receipt of the OIG's final recommendations, STOP intends to provide HHS, ACF with an amended package of closeout costs. The \$1,306.83 will be included in this package.

Section VI: GRANT CLOSEOUT COSTS:

As instructed by the Department of Health and Human Services (HHS), STOP submitted its final Head Start Closeout Package to [REDACTED], Acting Grants Management Officer, HHS, Administration for Children and Families (ACF). Region III, on October 31, 2011. **To date, we have not had any response from HHS regarding our Closeout Package.**

While we thoroughly understand that the draft audit recommendation from the OIG is somewhat a separate issue from our grant closeout with HHS, we believe it necessary and appropriate to mention it here that STOP has borne additional costs to include but not be limited to labor expenses which were necessary to close out the Head Start grant.

The STOP Board and Staff sincerely hope that at some appropriate time, in the near future, expenses such as these mentioned, will be considered as a means to offset an additional amount of the recommended disallowed costs reflected in the draft OIG audit report.

Section VII: SUMMARY

The Board of Directors and Administrative Staff of STOP sincerely hope that we have provided strong source documentation as a solid basis for consideration in substituting allowable costs for disallowable costs associated with our Head Start Program for Grant Year April 1, 2010 through March 31, 2011. We are certainly open to respond to any requests for additional information and/or further discussion.

STOP's current Board and staff will continue to **re-think, re-evaluate, re-organize and re-invent** what we do to increase agency-wide efficiency, both financially and programmatically. In light of what we have learned over the past two years, we cannot and will not conduct "business as usual". We will continue to work diligently to provide services and programs which produce positive outcomes for the individuals, families and communities we serve while at the same time working towards restoring the public's confidence by demonstrating our commitment to sound, financial practices and accountability.

APPENDIX C: OFFICE OF HEAD START COMMENTS


 ADMINISTRATION FOR
CHILDREN & FAMILIES

 Office of Head Start | Region III | 150 S. Independence Mall West, Suite 864, Philadelphia, PA 19106 | eclkc.ohs.acf.hhs.gov

November 29, 2012

To: Stephen Virbitsky, Regional Inspector General for Audit Services
 Office of Inspector General

From: Linda M. Savage, Regional Program Manager
 Office of Head Start

LS - 1-18-2013

 Patricia L. Fisher, Regional Grants Management Officer
 Office of Grants Management

*PLF
1/18/2013*
Subject: CIN A-03-11-00501 Audit Response

Grantee: Southeastern Tidewater Opportunity Project, Inc.

This statement is in response to the draft audit report submitted to the Department of Health and Human Services (DHHS), Administration for Children and Families (ACF), Office of Head Start (OHS) for comments dated November 1, 2012. This draft report concerning Southeastern Tidewater Opportunity Project, Inc. (STOP), Common Identification Number (CIN) A-03-11-00501, covered the period April 1, 2010 through March 31, 2011 and examined expenditures under two separate grants awarded to STOP during that period, specifically Grant Numbers 03CH2001 and 03SE2001. This correspondence addresses the Office of Head Start's position on the three findings and recommendation identified in the draft audit report and any modifications to the initial draft report submitted.

Again, the Regional Office would like to note that prior to the grantee self reporting financial mis-management, all records reviewed by the Regional Office showed no indication of poor financial management practices. It is the practice of the Regional Office to review audit reports for findings, payment management system reports, and financial reports on a regular basis and all of these documents gave no indication of the dire financial situation of this grantee. It should also be noted that once the Regional Office conducted its initial investigation into the financial status of this grantee the auditor rescinded their opinion for the prior audit period ending June 30, 2010 and the opinion was changed from unqualified to adverse.

It is the position of the Regional Office to concur with all adjustments stated in this draft report. The Regional Office plans to address any costs associated with grant closeout in a separate correspondence to the grantee. It should be noted that the Regional Office has reviewed the latest draft audit report and the evidence submitted substantiating the changes to the first draft and the following conclusions are a result:

Finding 1 - Unallowable Costs Claimed:

The draft audit report finding states that STOP recorded unallowable expenditures totaling \$949,399 modified from the previous amount of \$950,605: \$807,861 in costs incurred prior to the award period, \$120,161 in improperly allocated fringe benefit costs, \$15,768 modified from \$16,974 that was not supported by source documentation, and \$5,609 in duplicate payments. As a result the OIG recommends that ACF require STOP to refund the federal Government \$726,746 (adjusted for the current deductions) to the Head Start grant.

OHS and the Office of Grants Management (OGM) concur with the finding of unallowable costs claimed. The STOP organization contacted the Regional Office prior to the close of their grant period in 2011 to notify OHS that they had no more monies in their account for year ending March 31, 2011 and they were unable to make payroll. Upon further investigation it was determined from review of Payment Management System (PMS) documents that a significant draw had been made in April 2010 of the grant year in question. This gave the Regional Office the initial evidence to substantiate that the grantee's rate of expenditure was inconsistent with prior years and suggested risky practices of paying prior period costs with current year funding. STOP relinquished their Head Start grant in March 2011. Once the grant was relinquished no additional charges to the grant should have been incurred. It is due to this reason that OHS and OGM concur that the fringe benefits claimed for July and August 2011 are unallocable. In accordance with all applicable cost principles all costs incurred against the grant should have sufficient source documentation. It has been substantiated from this draft report that there are costs with no source documentation or duplicate costs were claimed. OHS and OGM concur that these cannot be claimed due to their inconsistency with the cost principles.

Finding 2 – Financial Management:

Federal standards for financial management systems (45 CFR § 74.21(b)(3)) require that recipients' financial management systems provide for effective control over and accountability for all funds, property and other assets. STOP's financial management system did not provide for effective control over and accountability for Head Start funds awarded for the audited grant year.

OHS and OGM concur with the finding related to financial management. In February 2011, the Regional Office received notification of STOP's inability to meet the financial obligations of the Head Start program. It was determined at that time that STOP did not provide effective control over and did not provide sufficient accountability for all grant funds. It was initially determined by the Regional Office that there was gross mismanagement of funds awarded to the STOP Head Start program and this report substantiates such claims.

Finding 3 – Financial Governance:

Section 642(c) of the Head Start Act requires that grantees establish and maintain a formal structure for program governance, including a governing body with legal and fiscal responsibility for administering and overseeing the Head Start agency, including the safeguarding of Federal funds. The governing body is responsible for reviewing financial audits and the grantee's progress in carrying out the programmatic and fiscal responsibilities described in the grant application. Section 642 (d)(2) requires grantees to ensure the sharing of accurate and regular information, including monthly financial statements and the financial audit, for use by the governing body. STOP's Board did not adequately monitor financial management practices.

OHS and OGM concur with the finding related to financial governance. On March 15, 2011 the Regional Office received a statement from STOP auditor N. Wesley Pughsley, Jr., CPA stating that the audit opinion for the prior year was being changed from unqualified to adverse. It was also noted in the statement from the auditor that "a culture was created in which Head Start funds were used for non Head Start expenses. Since there was no accounting for net assets, funds were not being reimbursed back to Head Start." The above finding provides proper evidence to substantiate this statement from the auditor. Evidence from this report and the final auditor's statement substantiates that it was a failure on the Board of Directors that resulted in this culture of mis-management of funds.

OIG Recommendation – The OIG recommends that ACF require STOP to refund the Federal Government \$726,746 related to the Head Start grant.

It is the joint opinion of OHS and OGM to concur with this recommendation based on the evidence provided by this investigation. It will be the action of the Regional Office to pursue the disallowance in the above stated amount.

We are available to meet with you to discuss our position on the above stated findings and recommendation and to answer any questions you may have. Thank you for the opportunity to comment on the draft report.

cc: Ann Linehan, Deputy Director, Office of Head Start
Yolanda Wise, Program Specialist, Office of Head Start
Tony Hardy, Director, Office of Grants Management