

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**SOUTHWESTERN COMMUNITY
ACTION COUNCIL, INC.**

HUNTINGTON, WEST VIRGINIA



**JUNE GIBBS BROWN
Inspector General**

**June 2000
A-03-00-00551**



DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES
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June 27, 2000

Harry W. Smith, Executive Director
Southwestern Community Action Council, Inc.
540 Fifth Avenue
Huntington, West Virginia 25701

Dear Mr. Smith:

This audit report presents the results of an Office of Inspector General (OIG) limited scope review of Southwestern Community Action Council, Inc. (SCAC) in Huntington, West Virginia. The Region III U.S. Department of Health and Human Services (HHS), Administration for Children and Families (ACF) requested this review after program deficiencies were noted in the triennial Head Start and Early Head Start On-Site Performance Review Instrument (OSPRI) performed in May 1999.

Based on our examination and analysis of financial information, supporting documentation and other available evidence, we found that SCAC:

- ☞ Overspent the Grant Year (GY) 1998 Head Start budget by \$56,000. The \$56,000 overexpenditure was satisfied by transferring funds from the accrued annual leave account which was funded in prior years.
- ☞ Overspent the GY 1999 Early Head Start budget by \$89,680 and subsequently transferred those expenses to the Head Start program. Thus, the Head Start program was charged for Early Head Start program expenses not related to the Head Start program.
- ☞ Did not reserve sufficient funds for employees' accrued annual leave. Head Start employees accumulated \$195,774 and Early Head Start employees accumulated \$24,554 in accrued leave benefits according to payroll records as of June 30, 1999. However, the accrued annual leave account contained only \$13,335, a deficit of \$206,993. These unclaimed prior years' expenses are not allowable as current or future years' expenses.
- ☞ Did not properly charge or allocate time spent by employees who worked on multiple programs.

- ☞ Did not prepare and manage realistic internal budgets for the four programs we reviewed. Within each program, budgeted line items were routinely exceeded and actual expenses were transferred from one expense category to another without justification or approval. Revenue from non-HHS sources such as the United Way and local school districts were routinely recorded as negative expenses instead of revenue.

We recommend that SCAC:

1. Refund \$145,680 for funds inappropriately claimed for the Head Start program. This includes:

- ☞ \$56,000 in costs reimbursed by the Head Start program prior to GY 1998 which were transferred by SCAC from the accrued annual leave account and used to satisfy GY 1998 Head Start overexpenditures.
- ☞ \$89,680 in costs that were claimed for the GY 1999 Head Start program that were incurred for and properly attributable to the Early Head Start program.

2. Ensure that annual leave funds accumulated in prior years and charged to the Head Start program are not used to satisfy program overexpenditures and that unclaimed prior years' leave expenses are not claimed against current or future years' grants.

3. Improve internal controls to ensure that time for employees who work on multiple programs is properly charged to all benefitting programs and review GY 1999 Early Head Start salary allocations to determine their appropriateness. Refund to the Federal government any over-allocated amounts.

4. Establish procedures to use realistic budgets as a management control. This should include preparing and updating budgets that accurately reflect current year activities and prior years' actual costs, establishing procedures to monitor journal entries, and requiring the justification of entries between cost categories and programs.

By letter dated June 5, 2000, SCAC responded to a draft of this report. The SCAC generally agreed with our findings. However, SCAC disagreed with our recommendation to refund \$145,680 for funds inappropriately claimed for the Head Start program.

We have reviewed SCAC's response and have included it as an Appendix to this report. We have also summarized their response, and presented our comments after each applicable finding area in this report. However, we have not made any significant changes to the findings contained in the report as a result of SCAC's response.

BACKGROUND

The SCAC was organized as a nonprofit organization in 1967 to develop and provide resources to low income individuals through a variety of programs. The SCAC received funding directly from Federal sources and Federal funds passed through the State of West Virginia. For SCAC's Fiscal Year (FY) 1998, HHS direct or pass through funds accounted for over 82 percent of Federal funds (Federal funds accounted for over 96 percent of SCAC's revenues). The primary Federal funding source was the HHS Head Start Program which accounted for nearly one-half of SCAC's revenues. The SCAC has operated a Head Start program for 29 years and in GY 1999 served 662 children.

Other significant HHS funded programs included the Early Head Start program which served 110 children, ages 0-3, and pregnant mothers; the Runaway and Homeless Youth (RHY) program; and the Transitional Housing program. The Transitional Housing program grant was not renewed in September 1999.

OBJECTIVE

Our objective was to determine if Federal funds were expended for allowable purposes, accounted for accurately, and safeguarded properly in accordance with grants management requirements for four specific HHS funded programs: Head Start, Early Head Start, RHY, and Transitional Housing. Our examination was not a full scale "quality of grantee management" review and was intended to address specific fiscal-related concerns noted in the OSPRI.

SCOPE AND METHODOLOGY

We conducted our limited scope review in accordance with the Government Auditing Standards (1994 Revision) issued by the Comptroller General of the United States. However, we did not follow all of the elements of the Planning Standards in Chapter 6. A request from ACF initiated this audit after an OSPRI identified financial problems. Consequently, our work focused on evaluating the financial issues raised in the request.

We did not conduct an extensive review of the SCAC's internal control systems. However, we did examine internal controls as they related to costs incurred under the grants we reviewed to assure compliance with Federal statutory and regulatory criteria and with the SCAC's policies and procedures. Because of the inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Except for the issues discussed in this report, nothing came to our attention that would cause us to believe SCAC's procedures were not adequate for our purposes.

Our review included tests and procedures that were considered necessary to meet the objectives of our review including obtaining an understanding of SCAC's accounting system and internal controls. We reconciled Unit Reports (internal accounting reports that compare actual to

budgeted amounts) from SCAC to the SF-269 Financial Status Reports and matched payroll related expenses (the largest expense SCAC incurred for the programs we reviewed) to the Unit Reports. We reviewed program costs to determine if they were attributed to the correct program and category of cost and were liquidated in the correct fiscal period. We reviewed the time and attendance reports for all multi-program staff working on the Head Start and Early Head Start programs for proper allocation of time. We also compared invoices to claimed expenses and reviewed procurement policies and procedures. As shown in the following table, our review covered Federal awards valued at about \$8.3 million for GYs 1998 and 1999:

SCAC Grants Reviewed		
PROGRAM	GRANT YEAR	AMOUNT AWARDED AND CLAIMED
Head Start	1998 (5/1/97 to 4/30/98)	\$3,426,451
Head Start	1999 (5/1/98 to 4/30/99)	\$3,157,466
Early Head Start	1999 (5/1/98 to 4/30/99)	\$1,097,588
Runaway Program	1998 (9/1/97 to 8/31/98)	\$110,474
Runaway Program	1999 (9/1/98 to 8/31/99)	\$133,897
Transitional Housing	1998 (10/1/97 to 9/30/98)	\$200,000
Transitional Housing	1999 (10/1/98 to 9/30/99)	\$200,000
TOTAL REVIEWED		\$8,325,876

We performed our review at SCAC’s offices in Huntington, West Virginia from November 1999 to February 2000.

RESULTS OF REVIEW

Our review disclosed that SCAC maintained an adequate system of internal control over procurement, including the bid process and controls over vendor invoices. However, SCAC improperly transferred Head Start funds from an accrued leave account to pay for unrelated expenses and moved expenses from one program to another to avoid a program deficit. The SCAC also lacked adequate controls over leave accrual accounting, allocation of time by multi-program funded employees, and internal budget management.

Use of Prior Year’s Funds to Cover GY 1998 Head Start Expenses

The SCAC overspent the Head Start Program budget by \$56,000 in GY 1998 and transferred funds from the accrued annual leave account reserve to satisfy the deficit. The budget for Head Start GY 1998 was \$3,246,451, and SCAC incurred costs of \$3,302,451. The \$56,000 transferred from the accrued annual leave bank account was claimed as a Head Start expense in prior years for accrued annual leave. The 45 CFR 74.21 (b)(6) (Standards for Financial Management Systems) and 45 CFR 74.28 (Period of Availability of Funds) require that costs be incurred during the funding period. Further, the Office of Management and Budget (OMB) Circular A-122 (Attachment A), made applicable to HHS grants by 45 CFR Part 74.27 (Allowable Costs) states that costs may not be shifted to other Federal awards to overcome funding deficiencies. Since the transferred amount of \$56,000 was not incurred in the funded period, was not used for its stated purpose (payment for annual leave) and the transfer was made to another Federal award to avoid a deficit situation, the claimed amount is not allowable. As shown in the table below, the \$56,000 in transferred funds was used to satisfy the following overspent Head Start accounts:

Account Name	Account Number	Amount
Unemployment Insurance	4363-002-073-002-008	\$28,102
Maintenance	4363-002-073-007-036	\$17,987
Vehicle Repair	4363-002-073-007-065	\$7,298
Central Office Telephone	4363-002-073-007-078	\$2,613
Total		\$56,000

SCAC Response:

The SCAC agreed that the GY 1998 Head Start budget was overspent by \$56,000 and this deficit was satisfied by transferring funds from the Head Start accrued annual leave account which was funded in prior years. However, SCAC does not believe they should have to return this amount to the Federal government.

The SCAC stated that when their management determined that the Head Start Program budget was overspent, SCAC's Comptroller asked the Audit Supervisor from SCAC's auditing firm if it was allowable to transfer monies from Head Start's accrued annual leave account to Head Start to cover this deficit. The Audit Supervisor told the Comptroller that if monies were transferred from the accrued annual leave account to cover this deficit it would not be questioned in the audit and added that he knew of no reason why they could not handle it in this manner. The SCAC stated that there clearly was no intention on their part to violate any part of 45 CFR 74.21 (b)(6) (Standards for Financial Management Systems), 45 CFR 74.28 (Period of Availability of Funds) or 45 CFR 74.27 (Allowable Costs) in regard to this transfer of funds as management relied strictly upon the answer obtained from the Audit Supervisor of their audit firm.

It is also SCAC's position that expenditures were made for specific program purposes and were for costs directly related to the necessary operations of the program.

OIG Comment:

The SCAC's reliance on incorrect advice does not justify using Federal funds for other than the purposes for which they were claimed. The transfer was a violation of Federal grant award criteria and cost principles since SCAC used funds claimed in prior years to cover unrelated expenses in a succeeding year.

Transfer of GY 1999 Early Head Start Expenses to the Head Start Program

The SCAC overspent the budget for the Early Head Start program in GY 1999 by \$89,680. The approved Early Head Start budget for GY 1999 was \$1,097,588, and SCAC incurred costs of \$1,187,268. Since the Early Head Start program was overspent and the Head Start program was not overspent for GY 1999, SCAC transferred the expenses from the Early Head Start program to the Head Start program. We identified \$89,680 in expenses that SCAC transferred as follows:

Early Head Start Expenses Transferred to Head Start	Amount Transferred
Salaries on 4/21/99	\$26,000
Salaries on 4/28/99	\$26,000
Salaries on 5/13/99	\$22,000
Purchase of Playground Equipment at Two Centers	\$11,800
Purchase of Two New Computers	\$3,880
Total	\$89,680

The salaries were directly related to the Early Head Start Program. The playground equipment and computers were specifically approved for the Early Head Start program as start-up costs to the grant award. However, the supplemental start-up funds that were available for these purchases were used by SCAC to cover other expenses incurred by the Early Head Start program.

The SCAC transferred the subsequent expenses to the Head Start Program. The OMB Circular A-122 Section A(4)(a) provides that a cost is allocable to a particular cost objective, such as a grant, in accordance with the relative benefits received and only if the cost is incurred specifically for the award. The funds made available for the Head Start program in this case were not intended to benefit the Early Head Start program, were not incurred for the Head Start program, and were therefore used for an unintended and unallowable purpose.

SCAC Response:

The SCAC agreed that the GY 1999 Early Head Start budget was overspent by approximately \$89,680 and that they subsequently transferred these expenses to the Head Start program. However, SCAC does not believe they should be responsible for \$74,000 of Early Head Start staff salaries that ultimately were charged to Head Start. The SCAC contends that Early Head Start was funded based on a budget proposal submitted and approved by HHS that contained no salary or fringe appropriations for some staff who had duties in the Early Head Start Program. Total salary and fringe costs for these particular staff were submitted in the Head Start budget proposal to HHS and approved by HHS. The SCAC management interpreted funding of the grant to indicate acceptance and approval of the budget. It is SCAC's position that it was thus appropriate to charge these costs to the Head Start budget.

The SCAC stated that subsequently, the ACF Regional Office advised them to charge appropriate allocable amounts of these salaries to the Early Head Start program. In response to this request, SCAC prepared a cost allocation percentage schedule for those specific staff approved in the Head Start budget for percentages to be assessed to the Early Head Start Program. This schedule was submitted to the Regional Office and approved.

The SCAC believes that they did everything they could to reimburse the Head Start Program for the full amount of allocable charges to Early Head Start during the 1999 GY. However, SCAC said that sufficient funds were not available in the Early Head Start budget. The SCAC was aware that additional reimbursements were due the Head Start grant, but all Early Head Start funds had been exhausted. It is SCAC's position that since they made every attempt to repay Head Start on a monthly basis in accordance with the cost allocation percentage schedule as approved by HHS, they should not have to repay the \$74,000 to the Federal government.

The SCAC explained that the \$11,800 playground equipment and \$3,880 computer equipment purchases that were for the Early Head Start program but subsequently charged to Head Start were inadvertent bookkeeping mistakes.

The SCAC believes that the wording in the report "*subsequently transferred these expenses to the Head Start Program*" is misleading as no expenses were transferred, moved or shifted from Early Head Start to Head Start for the specific purpose of paying the expense from Head Start funds because funds were not available in the Early Head Start budget. It is the position of SCAC that this point must be emphasized so that individuals reading the OIG audit report will not get the impression that SCAC knowingly transferred these expenses.

Again, it is SCAC's position that the expenditures were made for specific program purposes and were for costs directly related to the necessary operations of the program.

OIG Comment:

The SCAC agreed that they overspent the Early Head Start budget by approximately \$89,680. The fact that SCAC incurred more costs than were authorized does not obligate the Federal government to pay for the cost overruns. The OMB Circular A-122 (Attachment A) states that costs may not be shifted to other Federal awards to overcome funding deficiencies. The SCAC characterized the charging of the \$11,800 in equipment and \$3,880 in computers to the Head Start Program as mistakes; nevertheless, the mistakes resulted in violations of Federal award regulations.

The phrase in the report used by the OIG, “*transferred the subsequent expenses to the Head Start Program,*” is not misleading. Based upon our review of the recorded journal entries, the OIG statement accurately describes the actions taken by SCAC staff. However, the OIG does not imply that there was a conscious attempt by SCAC to deceive the awarding agency.

Accrued Annual Leave

The SCAC’s accrued annual leave account for the Head Start and Early Head Start programs as of June 30, 1999 was underfunded by \$206,993. The SCAC’s records indicated that \$220,328 should be accrued in the account. However, only \$13,335 was available in the bank account for Head Start and Early Head Start employees’ accrued annual leave payments. As previously mentioned, we found that SCAC transferred \$56,000 from the accrued annual leave account to satisfy overexpenditures in the GY 1999 Head Start grant. The SCAC never claimed the balance of accrued annual leave (\$150,993). The 45 CFR 74.28 states that a recipient of funds may charge to a Federal award only allowable costs resulting from obligations incurred during the funding period. Thus, unclaimed prior years’ expenses are not allowable as current or future years’ expenses.

SCAC Response:

The SCAC agreed that sufficient funds were not available in the FY 1998-1999 Head Start or Early Head Start Program budgets to reserve for employees' accrued annual leave benefits as of the June 30, 1999 liability. However, SCAC had never accounted for the accrued annual leave account as an expense, and charged it as an expense only when unexpended funds were available at the end of a contract and transferred to the accrued annual leave account.

The liability for the program staff's annual leave was calculated at the end of each program period and, based on that amount, any remaining grant funds were transferred to increase the amount until such time that the liability is satisfied. However, the Head Start and Early Head

Start budgets typically had little or no unexpended balances remaining and transfers to the program's account were limited. It is SCAC's position that unless funds are provided by HHS, it is most likely that sufficient funds for this account will never be available.

The SCAC stated that if their procedures on the establishment and use of program accrued annual leave accounts are not in compliance with HHS regulations, SCAC wants HHS to provide specific guidelines and instructions as to the procedures and policies for the establishment and use of these accounts. The SCAC advised that the existing procedures were recommended by one of SCAC's prior auditing firms and have been in place for a number of years. These procedures were also reviewed by various CPA firms and funding sources and never questioned.

OIG Comment:

The SCAC agreed that unfunded liabilities existed for the Early Head Start and Head Start accrued annual leave accounts. The OIG does not question the establishment of the accounts but does question charges made to the accounts that do not reflect current year operations since SCAC may only charge allowable costs resulting from obligations incurred during the funding period to a Federal award. Thus, unclaimed prior years' expenses are not allowable as current or future years' expenses. This guideline is contained in the Code of Federal Regulations (45 CFR 74.28).

Employee Time Allocations

Internal controls were not adequate to insure that all time for employees who worked on multiple programs was properly charged and allocated. In GY 1999, 39 employees who worked for the Head Start, Early Head Start, RHY, and Transitional Housing programs spent time working on multiple programs. Prior to September 1999, SCAC did not require employees to record how much time they actually spent on each program. Instead, estimates were used by the SCAC bookkeepers to allocate time among programs. The percentage estimates used by the bookkeepers were provided by support staff who worked for the program directors. Documentation to support the percentages estimated was not available.

Prior to the inception of the Early Head Start program, Head Start employees charged all time to the Head Start program. When the Early Head Start program started in May 1998, Early Head Start employees, who also worked part-time on Head Start, continued to charge all of their time to the Head Start program. In July 1998, SCAC began using an unsupported estimate for 18 of 23 multi-program Head Start and Early Head Start employees to allocate 85 percent of their time to Head Start and 15 percent to the Early Head Start program. The SCAC charged the split percentage for only 5 months from July 1, 1998 to November 30, 1998 and discontinued the

allocation because the Early Head Start program was running out of money. Had SCAC charged the same allocated salary percentages for the other months of the grant period, the Early Head Start program charges would have exceeded the budget by an additional \$69,546.

Likewise seven multi-program funded RHY employees were arbitrarily charged to four HHS programs on the basis of unsupported estimates as follows:

Program	Percentage
Transitional Housing	26.0%
CBS Medicaid	41.0%
RHY	9.5%
TOYS/Medicaid	23.5%
Total	100.0%

In September 1999, SCAC took corrective action recommended by the OSPRI to start recording actual time spent by employees who worked on multiple programs. However, the revised system was limited to only the seven multi-funded RHY employees. Time sheets prepared by RHY employees in September 1999 showed that they worked on more than the four programs that they had charged in prior months, including non-HHS and non-Federal programs. However, the time sheets prepared in September 1999 were not uniform and were imprecise in describing the employees' efforts. As a result, the SCAC bookkeeper did not understand the time sheets and continued to use the unsupported percentages that were used for the first 11 months of the GY. For example, in September 1999 one employee's time sheet read as follows:

Program	Hours	Minutes
Runaway (RYP)	3	15
Transitional Housing (THP)	3	10
Runaway/Medicaid	4	15
TOYS/Medicaid	6	15
Multi-county	4	45
ABLE	3	45
All	8	20
Other	28	15
Sick	13	0
Holiday	16	0
Total	91	0

The complexity of the time sheets confused the bookkeeper due to the employee recording time to “all” programs and “other” programs. The 45 CFR 74.21 and OMB Circular A-122 (Attachment A) both state that if a grantee is operating a multi-funded program, records must adequately identify the source and application of funds. We determined that multi-program employees often charged time to a variety of programs. Yet, because of the arbitrary and unsupported allocations, only Federal programs were allocated the employees’ time. Therefore, the Federal programs were overcharged. However, SCAC did not provide the supporting documentation to determine the amount of effort actually expended on the various programs and the resulting overcharges in past years.

At the conclusion of our fieldwork in February 2000, SCAC was developing a supportable timekeeping system for Head Start and Early Head Start employees. However, at that time, SCAC’s guidance was not clear as to whether the guidance applies to Head Start and Early Head Start only or if all programs are to be included. In SCAC’s response to our draft audit report they stated that the timekeeping system will apply to all programs.

SCAC Response:

The SCAC believes they charged or allocated time spent by employees who worked on multiple programs to the appropriate grants. The SCAC developed an allocation schedule for the Head Start/Early Head Start employees. However, SCAC agrees with recommendations made by the OIG audit and says these recommendations have made the allocation procedures much easier to

maintain. Furthermore, the SCAC stated that internal controls have been strengthened to ensure that time for employees who work on multiple programs is properly charged to all benefitting programs.

The SCAC disagrees that they charged the split percentage for only 5 months from July 1, 1998 to November 30, 1998 and discontinued the allocation because the Early Head Start Program was running out of money. They also disagree that had they charged the same allocated salary percentages for the other months of the grant period, the Early Head Start Program charges would have exceeded the budget by an additional \$69,546.

The SCAC made allocations retroactive to May 1, 1998 or the beginning of the contract and the charges were made until March 1999. A final allocation payment was made in July 1999 in the amount of \$15,395.94 for a portion of the March and April charges. This amount was all that was available in the Early Head Start budget to reimburse the Head Start Program.

OIG Comment:

The 45 CFR 74.21 and OMB Circular A-122 (Attachment A) both state that if a grantee operates a multi-funded program, records must adequately identify the source and application of funds. The payroll records clearly showed that time for employees who worked on both Head Start and Early Head Start was allocated between the Early Head Start and Head Start programs for only 5 months. Salary costs for employees who worked on both programs for the other 7 months were completely charged to the Head Start program. During this 7-month period, only employees who worked 100 percent of the time on Early Head Start were charged to Early Head Start (to the extent that funds were available).

The Runaway and Transition Housing Division did show actual total hours spent on various grants for 1 month during the grant period we reviewed. However, only Federal programs were allocated the employees' time.

Therefore, our position that the Federal programs were overcharged is not changed.

Budget Management

The SCAC did not prepare and manage realistic internal budgets for the four programs we reviewed. Budgeted line items were routinely exceeded, and SCAC transferred actual expenses from one expense category to another without justification or approval by ACF or SCAC's officials as necessary. The SCAC indicated that the budget problems were in large part caused by the time lag between budget preparation and budget execution.

The SCAC did not properly use the internal budget as a management control over Federal funds. The SCAC initially recorded transactions in the correct accounts throughout the year, but then moved expenses from one account to another without support for the transactions. The SCAC did not prepare budget modifications when expenses exceeded budgeted amounts. The following transactions are examples of postings that were based on availability of funds in accounts rather than the actual source or application of funds.

Head Start Transactions Affecting SCAC Expense Accounts			
Date	Account Credited	Account Debited	Amount
4/22/99	Salaries	Health and Life Insurance	\$60,000
4/22/99	Salaries	Employee Retirement	\$53,937
4/22/99	Moving Expense	Recreation	\$1,900
4/22/99	Salaries	Health and Life Insurance	\$6,020
4/22/99	Social Security Tax	Health and Life Insurance	\$2,400

We found that the expenses were, in fact, incurred. However, the transactions were not accurately reflected in the financial records. In addition, revenue from non-HHS sources such as the United Way and local school districts was recorded as negative expenses instead of as revenue. These incorrectly recorded transactions contributed to the difficulty in preparing meaningful budgets for future years because the historical costs were distorted. The lack of proper budget controls also limits the effectiveness of management and Board oversight.

SCAC Response:

The SCAC contends that the preparation and management of realistic budgets for the four programs reviewed was done. The procedure for preparation of a renewal budget has always been to review the previous contract’s budget for final expenditures and use this as a guide. In addition, the program director obtains from accounting an update on all current fringe charges and any internal management, bookkeeping and fringe assessments. Then, the budget is finalized with funds allocated in specific line items where these expenditures are anticipated. However, the SCAC agreed with our recommendations to improve budget management. As a result, the SCAC says they have established procedures and/or reinforced existing procedures that will ensure realistic budgets are properly prepared and maintained as a management control. This includes preparing and updating (amending) existing budgets that will accurately reflect current year activities.

The SCAC concurs that budgeted line items were routinely exceeded but contends this is not a violation of HHS budget policies. The SCAC believes HHS regulations address budgeted cost categories and not line items within those cost categories, to give some flexibility to agencies

operating under contract agreements. Thus, during the period of the review, line items were overspent, but cost categories were within flexibility guidelines. At the present time, based on the Quality Improvement Plan (QIP) submitted to the ACF Regional Office, budget amendments are done for Head Start and Early Head Start Programs on a monthly basis for line items within cost categories and presented for approval by the Grantee Finance Committee and Board of Directors.

The SCAC concurs that in one program, expenses were transferred by journal entries, but this was inadvertently done by the bookkeeper who intended to transfer line item budget allocations but transferred expenses instead. The Comptroller has reportedly implemented procedures for the review and approval of all journal entries.

The SCAC explained that program reimbursements have routinely been credited to line items from which corresponding expenses are made but have never been viewed as negative expenses. However, as recommended by OIG, SCAC has amended all program budgets in order that all reimbursements will be shown as revenues to different line items and not credits to existing line items on monthly expenditure reports.

OIG Comment:

The use of a budget is an important management internal control over agency practices, including those involving the expenditure of Federal funds. The budget should serve as a guide to be referenced when management decisions are necessary. The SCAC practice of preparing budgets that are not updated, recording income as negative expenses, and transferring actual expenses to various unrelated accounts hampered the budget process. Better budget controls and monitoring will help SCAC to ensure that expenses remain in line with authorized funds.

CONCLUSIONS AND RECOMMENDATIONS

Our review disclosed that SCAC maintained an adequate system of internal control over procurement, including the bid process and controls over vendor invoices. However, our examination confirmed several concerns raised by the OSPRI review performed in May 1999 related to cost transfers, leave accrual accounting, time allocation and budget management.

We recommend that SCAC:

1. Refund \$145,680 for funds inappropriately claimed for the Head Start program. This includes:
 - ☞ \$56,000 in costs reimbursed by the Head Start program prior to GY 1998 which were transferred by SCAC from the accrued annual leave account and used to satisfy GY 1998 Head Start overexpenditures.
 - ☞ \$89,680 in costs that were claimed for the GY 1999 Head Start program that were incurred for and properly attributable to the Early Head Start program.
2. Ensure that annual leave funds accumulated in prior years and charged to the Head Start program are not used to satisfy program overexpenditures and that unclaimed prior years' leave expenses are not claimed against current or future years' grants.
3. Improve internal controls to ensure that time for employees who work on multiple programs is properly charged to all benefitting programs and review GY 1999 Early Head Start salary allocations to determine their appropriateness. Refund to the Federal government any over-allocated amounts.
4. Establish procedures to use realistic budgets as a management control. This should include preparing and updating budgets that accurately reflect current year activities and prior years' actual costs, establishing procedures to monitor journal entries and requiring the justification of entries between cost categories and programs.

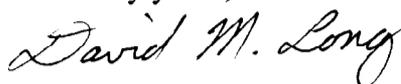
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Final determination as to actions to be taken on all matters reported will be made by the HHS official referenced below. The HHS action official will contact you to resolve the issues in this audit report. Any additional comments or information that you believe may be bearing on the resolution of this audit may be presented at that time. Should you have any questions, please direct them to the HHS official at the address below.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), HHS/OIG Office of Audit Services reports issued to the Department's grantees and contractors are made public to the extent information contained therein is not subject to the exemptions in the Act, which the Department chooses to exercise. (See Section 5.71 of the Department's Public Information Regulation, dated August 1994, as revised.)

To facilitate identification, please refer to Common Identification Number A-03-00-00551 in all correspondence relating to this report.

Sincerely yours,



David M. Long
Regional Inspector General
for Audit Services

Direct Reply to HHS Action Official:

Grants Officer
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**Southwestern Community Action Council, Inc.**

June 14, 2000

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JUN 16 2000

REF: A-03-00-00551

Dear Mr. Long:

I want to thank your office for granting Southwestern an extension to June 16, for our written comments pertaining to the OIG draft audit report. Also, the management and staff of Southwestern are grateful for the assistance provided by Charlie Hubbs and John Brisco during their time spent at the agency. In addition, we certainly appreciated the manner in which the exit conference was conducted by Charlie Hubbs on Thursday, June 8.

The following are comments Southwestern desires to make in regard to the draft audit report entitled "REVIEW OF SOUTHWESTERN COMMUNITY ACTION COUNCIL, INC. HUNTINGTON, WEST VIRGINIA."

PAGE 1 - ITEM 1

Southwestern agrees that the FY 1997-1998 Head Start budget was overspent by \$56,000 and this deficit was satisfied by transferring funds from the Head Start accrued annual leave account which was funded in prior years. However, the agency does not believe it should have to return this amount to the federal government because of the following:

When management determined that the Head Start Program budget was overspent the agency's Comptroller talked with Mr. Lee Powell, Audit Supervisor for Kelley, Galloway & Company, PSC, Southwestern's auditing firm. Mr. Powell was asked him if it was allowable to transfer monies from Head Start's accrued annual leave account to Head Start to cover this deficit. Mr. Powell told the agency's Comptroller, Mrs. Jane Terry, that if monies were transferred from the accrued annual leave account to cover this deficit it would not be questioned in the audit and added that he knew of no reason why we couldn't handle it in this manner. There clearly was no intention on the part of

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Southwestern to violate any part of 45 CFR 74.21 (b)(6) (Standards for Financial Management Systems), 45 CFR 74.28 (Period of Availability of Funds) or 45 CFR 74.27 (Allowable Costs) in regard to this transfer of funds as management relied strictly upon the answer obtained from Mr. Powell of the agency's audit firm.

The draft audit report lists the specific four (4) line items that made up the \$56,000 Head Start over expenditure (see chart on page 5) and the following facts should be noted in regard to this matter. Over 50% of the total deficit was in the UNEMPLOYMENT INSURANCE line item and resulted because the State of West Virginia increased the unemployment insurance premium rate from 6.5% to 7.5% on the first \$8,000 of gross wages effective January 1, 1998. There was no way that management could have anticipated these additional premium charges and funds were just not available from other areas of the budget to meet these unexpected expenditures during the last couple of months of the contract period. A second line item, MAINTENANCE, was also overspent by \$17,987 or 32% of the total deficit and, likewise, these costs were not anticipated when the budget was prepared for submission to DHHS for funding. These unexpected outlays became necessary when the agency encountered unexpected closings of several Head Start centers resulting in the necessity of opening new centers. Maintenance costs were incurred, as it was necessary to get these new centers open in order to serve the number of Head Start children as required in the grant. Another line item, VEHICLE REPAIR was overspent by \$7,298 or 13% of the total deficit. These outlays were necessary in order to provide the necessary transportation services to children enrolled in the program. The fourth line item, CENTRAL OFFICE TELEPHONE, was overspent by \$2,613 or 5% of the total deficit and was for necessary administrative operations.

The purpose in explaining each of these line items overspent is to spell out exactly why this occurred and to show that all of these costs were a necessary part of the Head Start regular program operation. There were no major new initiatives undertaken, no new equipment purchased, no additional staff hired, no additional fringes offered to staff, etc. However, these costs were normal on-going costs that were a part of the previous year's program budget but increased significantly because of the reasons outlined above. This is why Southwestern feels that it should not be placed in the position of having to return \$56,000 to the federal government that it does not have.

PAGE 1 – ITEM 2

Southwestern agrees that the FY 1998-1999 Early Head Start budget was overspent by approximately \$89,680 and subsequently those expenses were charged to the Head Start Program as contained in the draft audit report.

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However, Southwestern does not believe it should be responsible for the \$74,000 of Early Head Start staff salaries that ultimately got charged to Head Start. The agency submitted a budget proposal for Head Start with total salary and fringe costs for some staff that did have some duties in the Early Head Start Program. The approval and funding of both of this grant by DHHS was interpreted by Southwestern to mean that it would be alright to charge these costs in question as approved in the Head Start budget proposal.

Subsequently, the Regional Office advised Southwestern to charge appropriate allocable amounts of these salaries to the Early Head Start Program. In response to this request, the agency prepared a cost allocation percentage schedule for those specific staff approved in the Head Start budget for percentages to be assessed to Early Head Start. This schedule was submitted to the Regional Office and approved. Immediately thereafter, charges were assessed the Early Head Start Program budget, in accordance with this schedule, retroactive to May 1, 1998, or the beginning of the grant until March 1999. At this time, payments of allocated salary and fringe costs were discontinued because it was clear that sufficient funds were not available in the Early Head Start budget to continue paying the entire allocable amount on a monthly basis. The final payment was made from Early Head Start to Head Start in July 1999 during the closeout process with all Early Head Start remaining monies (\$15,395.94) being transferred to Head Start for salary and fringe cost reimbursements.

Southwestern did everything it could to reimburse the Head Start Program for the full amount of allocable charges to Early Head Start during the 1998-1999 contract. However, as indicated above, the agency came up short as sufficient monies were not available in the Early Head Start budget. The agency was aware that additional reimbursements were due the Head Start grant but all Early Head Start funds had been exhausted. Since the agency made every attempt to repay Head Start on a monthly basis in accordance with the cost allocation percentage schedule as approved by DHHS Southwestern believes that it should not have to repay this \$74,000 to the federal government.

The \$11,800 playground equipment purchase that was for the Early Head Start Program but subsequently got charged to Head Start was an inadvertent mistake. The bids obtained for the playground equipment clearly indicated Crum EHS center and Harts EHS center, the minutes of the Board of Directors Finance Committee meeting clearly state that this equipment was approved for the two (2) Early Head Start centers, the delivery receipt was marked Early Head Start as well as all attached purchase documents. However, the last document in the agency's purchasing process was the attachment of a coding slip by the program's purchase agent and this is where Head Start was entered by mistake. When the bookkeeper received the packet of documents she entered the data into the computer from the coding slip and the expenditure got charged to Head Start.

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In no way was this expenditure TRANSFERRED to Head Start for lack of funds but simply got charged to that grant as outlined above.

In addition, the \$3,880 for two (2) computers purchased for Early Head Start but later got charged to Head Start through a journal entry was an honest mistake on the part of the bookkeeper. Three computers had been purchased, two (2) for Early Head Start and one (1) for Head Start. After payment had properly been made and charged appropriately, the bookkeeper was reviewing the expenditure and looked at the documentation for the Head Start computer and thought that all three (3) were to have been charged in that manner. Thus, she did a journal entry and transferred the \$3,880 to Head Start making the total amount of the purchase (\$5,820) charged to Head Start. Again, the \$3,880 was an Early Head Start expense that did in fact get transferred to Head Start but was not intentionally done because of insufficient funds.

Southwestern believes that the wording "subsequently transferred these expenses to the Head Start Program" is misleading as no expenses were "transferred", "moved" or "shifted" from Early Head Start to Head Start for the specific purpose of paying the expense from Head Start funds because funds were not available in the Early Head Start budget. We believe this response must be emphasized in order that individuals reading the OIG draft audit report will not get the impression that the agency knowingly transferred these expenses.

PAGE 1 - ITEM 3

Southwestern agrees that sufficient funds were not available in the FY 1998-1999 Head Start or Early Head Start Program budgets to reserve for employees' accrued annual leave benefits as of the June 30, 1999 liability. However, management has never accounted for the accrued annual leave liability as an EXPENSE and charges it as an expense only when unexpended funds are available at the end of a contract and transferred to the accrued annual leave account. In addition, Southwestern respectfully requests that DHHS provide additional funding to Southwestern in order to adequately fund this liability.

The agency's procedures for establishing a program's accrued annual leave account have been to transfer any unexpended funds from that specific program when they are available at the end of a contract period. The liability for the program staff's annual leave is calculated at the end of each program period and, based on that amount, any remaining grant funds are transferred to increase the amount until such time that the liability is satisfied. However, the Head Start and Early Head Start budgets typically have little or no unexpended balances remaining and transfers to the program's account

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have been limited. Therefore, unless funds are provided by DHHS, it is most likely that sufficient funds for this liability will never be available.

If the agency's procedures on the establishment and use of program accrued annual leave accounts is not in compliance with DHHS regulations, then, management wishes DHHS to provide specific guidelines and instructions as to the procedures and policies for the implementation and subsequent use of these accounts. The existing procedures were recommended by one of the agency's prior auditing firms, have been in place for a number of years, reviewed by various CPA firms and funding sources and never questioned.

PAGE 1 – ITEM 4

Southwestern believes that it did charge or allocate time spent by employees who worked on multiple programs to those grants. Management did develop an allocation schedule (See Page 1 – Item 2) for the Head Start/Early Head Start employees. In addition, those employees working in the TOCCS division did show the total hours spent on various grants and salary and fringe costs were appropriately charged. However, management does agree with recommendations made during the OIG audit that have made the allocation procedures much easier to maintain.

PAGE 2 – ITEM 1

Southwestern contends that the preparation and management of realistic budgets for the four (4) programs reviewed was maintained. The procedure for preparation of a renewal budget has always been to closely review the previous contract's budget for final expenditures and use this as a guide. In addition, the program director obtains from accounting an update on all current fringe charges and any internal management, bookkeeping and fringe assessments. Then, the budget is finalized with funds allocated in specific line items where these expenditures are anticipated.

Management concurs that budgeted line items were routinely exceeded but contends this is not a violation of DHHS budget policies. DHHS regulations address budgeted cost categories and not line items within those cost categories when dealing with flexibility. Thus, during the period of the review, line items were overspent but cost categories were within flexibility guidelines. At the present time, based on the QIP submitted to the Regional Office, budget amendments are done for Head Start and Early Head Start Programs on a monthly basis for line items within cost categories and presented for approved by the Grantee Finance Committee and Board of Directors.

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Management does concur that in one (1) program, expenses were transferred via journal entries but this was inadvertently done by the bookkeeper as she intended to transfer line item budget allocations but transferred expenses instead. The agency's Comptroller has put procedures in place for the review and approval of all journal entries.

Program reimbursements have routinely been credited to line items from which corresponding expenses are made but have never been viewed as negative expenses. However, as recommended by OIG, Southwestern has amended all program budgets in order that all reimbursements will be shown as revenues to different line items and not credits to existing line items on monthly expenditure reports. However, as a result of implementing this procedure, it will cause the line item to reflect an overexpenditure where there is an offset reimbursement line item.

PAGE 2 – NUMBER 1

As previously indicated in this official response, Southwestern agrees with the approximate amount that the OIG report indicates as Head Start expenses but strongly defends its position of not having to refund any money to the federal government based on the information previously outlined. Furthermore, based on these facts, the agency respectfully requests that OIG not recommend to the Department of Health and Human Services, ACF Region III Office that this amount be refunded.

All expenditures were made for specific program purposes, were for costs directly related to the necessary operations of the program and resulted from situations outlined in previous explanations, i.e. Page 1 – Item 1. Also, Early Head Start was funded based on a budget proposal submitted and approved by DHHS that contained no salary or fringe appropriations for some staff who did have duties in the Early Head Start Program. Total salary and fringe costs for these particular staff were submitted in the Head Start budget proposal to DHHS and approved. Management interpreted funding of the grant to indicate acceptance and approval of the budget. Thus, it is our position that it was appropriate to charge these costs to the Head Start budget.

Southwestern does not have any money to return to DHHS and if forced to do so it would cause an unbearable hardship on the agency in regard to the operations of the Head Start and Early Head Start Programs. The agency strives to operate superior Early Head Start and Head Start Programs and believes that if confronted with having to repay the funds then it would hinder staff in performing their primary purpose of operating a quality program for children and families throughout the agency's service area.

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Southwestern ensures that no annual leave funds accumulated in prior years and charged to the Head Start Program's accrued annual leave account will ever be used in the future to satisfy a Head Start or Early Head Start Program over expenditure and that these monies will only be used for the specific purpose of paying employee's accrued annual leave upon separation from the agency in these particular programs.

PAGE 2 – NUMBER 3

Southwestern assures OIG and DHHS that internal controls have been strengthened to ensure that time for employees who work on multiple programs is properly charged to all benefiting programs.

PAGE 2 – NUMBER 4

Southwestern has established procedures and/or reinforced existing procedures that will ensure realistic budgets are properly prepared and maintained as a management control. This does include preparing and updating (amending) existing budgets that will accurately reflect current year activities. In addition, all journal entries will be monitored and approved by the agency's Comptroller.

PAGE 4 - RESULTS OF REVIEW

The OIG draft audit report states that SCAC improperly transferred Head Start funds from an accrued annual leave account to pay for unrelated expenses. This statement is misleading in view of the fact that a conversation was held with the agency's CPA firm's audit chief on this matter and made the transfer based on his stated position. The transfer may be termed "improper" in the OIG draft audit report but, at the time the transfer was made, it certainly was not viewed as improper by management based on the information obtained. In fact, when this matter was discussed with one of the OIG staff members performing the audit, his initial position on the transfer was not clear and he indicated that he would have to check it out further to see if it was proper.

Also, as previously covered in this response, the phrase "moved expenses from one program to another to avoid a program deficit" is denied by Southwestern. The agency did not transfer any expenses from Early Head Start to Head Start for this implied purpose. Again, based on how the statement is worded, one can easily come to the conclusion that transfers of Early Head Start costs were intentionally transferred to Head Start to avoid an Early Head Start deficit and this is just not true.

PAGE 7 – EMPLOYEE TIME ALLOCATIONS

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The statement in paragraph 1 "estimates were used by the SCAC bookkeepers to allocate time among programs" is misleading and can be interpreted that the bookkeepers were the staff that established the allocation percentages. The percentages were established by the appropriate program directors and support staff and the bookkeepers used the percentages as determined by these staff.

Also, the statements that "SCAC charged the split percentage for only 5 months from July 1, 1998 to November 30, 1998 and discontinued the allocation because the Early Head Start Program was running out of money and had SCAC charged the same allocated salary percentages for the other months of the grant period, the Early Head Start Program charges would have exceeded the budget by an additional \$69,546" is not true.

As indicated earlier in this response, the allocations were made retroactive to May 1, 1998 or the beginning of the contract and the charges were made until March 1999. A final allocation payment was made in July 1999 in the amount of \$15,395.94 for a portion of the March and April charges as this was all that was available in the Early Head Start budget to reimburse Head Start Program.

PAGE 8 – FINAL PARAGRAPH

The draft audit report states that at the conclusion of the fieldwork in February 2000, it was not clear if Southwestern's guidance for developing a supportable timekeeping system applied to Head Start and Early Head Start only or if all programs were to be included. This is to assure OIG and DHHS that the system will apply to all programs and not just Head Start and Early Head Start.

CONCLUSION

The draft audit report revealed that all Early Head Start and Head Start funds were properly accounted for and these funds were used to benefit Early Head Start and Head Start children and families. In addition, no funds were spent on anything that would be considered questionable. This agency's record for serving children and families over three (3) decades will rank at the top of all programs in Region III.

Also, Southwestern contends that any indication or suggestion that this program did something illegal would be completely false and in no way reflect the great job this agency does for the children and families it serves.

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Therefore, it is Southwestern's position that the agency should not have to pay any funds back to the federal government.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Harry W. Smith, Jr.", written in dark ink.

Harry W. Smith, Jr.
Executive Director
Southwestern Community Action Council, Inc.

cc: David Lett, Regional Administrator, ACF Region III