Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

ARIZONA IMPROPERLY CLAIMED SOME CHILD CARE AND DEVELOPMENT TARGETED FUNDS

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

DEPARTMENT OF HEALTH & HUMAN SERVICES · USA

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Office of Inspector General

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EXECUTIVE SUMMARY

Arizona claimed $2.2 million of unallowable Child Care and Development targeted funds for fiscal year 2009.

WHY WE DID THIS REVIEW

The Child Care and Development Fund (CCDF) provides discretionary funding for three targeted funds known as Infant and Toddler, Quality, and School Age Resource and Referral funds. These targeted funds are used for activities that improve the availability, quality, and affordability of childcare and to support the administration of these activities. The Federal Government provides 100 percent of these funds. Previous Office of Inspector General reviews found that States did not always comply with Federal requirements for the use of CCDF targeted funds.

The objective of this review was to determine whether the Arizona Department of Economic Security (State agency) complied with Federal requirements for the use of CCDF targeted funds for Federal reimbursement for Federal fiscal years (FYs) 2007 through 2009.

BACKGROUND

Under the CCDF program, States have considerable latitude in administering and implementing their childcare programs. Each State must develop, and submit to the Administration for Children and Families (ACF) for approval, a State plan that identifies the purposes for which CCDF funds will be expended for two grant periods (i.e., 2 FYs). Program requirements state that a State agency has 2 FYs to obligate CCDF funds and a third FY to liquidate those funds. The State plan must also designate a lead agency responsible for administering childcare programs. In addition, States are required to report expenditures of targeted funds on the quarterly Child Care and Development ACF-696 Financial Report (ACF-696 report), which is a cumulative report for the FY.

In Arizona, the State agency is the lead agency. As the lead agency, the State agency is required to oversee the expenditure of funds by providers, contractors, and other agencies of the Arizona State government to ensure that the funds are expended in accordance with Federal requirements. We reviewed all of the $29,443,756 of CCDF targeted fund expenditures that the State agency reported on its ACF-696 reports for FYs 2007 through 2009.

WHAT WE FOUND

Of the $29,443,756 of CCDF targeted fund expenditures that we reviewed, the State agency complied with Federal requirements for the use of $27,199,673. However, the State agency did not comply with Federal requirements for the use of the remaining $2,244,083. Specifically, the State agency improperly obligated $2,244,083 of FY 2009 targeted funds after the obligation period had ended.

The State agency did not have written policies and procedures addressing the monitoring of the obligation and liquidation of the targeted funds. Without necessary policies and procedures, the State agency could not identify which specific expenditures would be allowable for a particular FY.

WHAT WE RECOMMEND

We recommend that the State agency:

- refund to the Federal Government $2,244,083 for CCDF targeted funds that were not properly obligated and liquidated and

- develop and implement policies and procedures to address the monitoring of the obligation and liquidation of CCDF targeted funds to ensure that the funds are properly obligated and liquidated.

STATE AGENCY COMMENTS AND OUR RESPONSE

In written comments on our draft report, the State agency indicated that it would not challenge our finding that it had improperly obligated $2,244,083 of targeted funds. However, the State agency did not concur with our recommendation to refund this amount. The State agency commented that its noncompliance "resulted from an unintentional misunderstanding of the process, rather than willful misrepresentation" on its financial reports. The State agency provided information on corrective actions that it had taken regarding our finding. The State agency concurred with our other recommendation and provided information on actions that it had taken or planned to take to address this recommendation.

After reviewing the State agency's comments, we maintain that our recommendation to refund $2,244,083 to the Federal Government is valid.

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INTRODUCTION

WHY WE DID THIS REVIEW

The Child Care and Development Fund (CCDF) provides discretionary funding for three targeted funds, administered at the Federal level by the U.S. Department of Health and Human Services, Administration for Children and Families (ACF), and known as Infant and Toddler, Quality, and School Age Resource and Referral funds. These targeted funds are used for activities that improve the availability, quality, and affordability of childcare and to support the administration of these activities. The Federal Government provides 100 percent of these funds. Previous Office of Inspector General (OIG) reviews found that States did not always comply with Federal requirements for the use of CCDF targeted funds. (Appendix A contains a list of OIG reports on States' use of targeted funds.)

OBJECTIVE

Our objective was to determine whether the Arizona Department of Economic Security (State agency) complied with Federal requirements for the use of CCDF targeted funds for Federal reimbursement for Federal fiscal years (FYs) 2007 through 2009.

BACKGROUND

Under the CCDF program, States have considerable latitude in implementing and administering their childcare programs. Each State must develop, and submit to ACF for approval, a State plan that identifies the purposes for which CCDF funds will be expended for two grant periods (i.e., 2 FYs). Program requirements state that a State agency has 2 FYs to obligate CCDF funds and a third FY to liquidate those funds. Table 1 shows the obligation and liquidation periods for each FY covered by our review.

Table 1: Obligation and Liquidation Periods for FYs 2007 Through 2009

FY	Obligation Period Start Date	Obligation Period End Date	Liquidation Period End Date
2007	10/1/2006	9/30/2008	9/30/2009
2008	10/1/2007	9/30/2009	9/30/2010
2009	10/1/2008	9/30/2010	9/30/2011

The State plan must also designate a lead agency responsible for administering childcare programs. In addition, States are required to report expenditures of targeted funds on the quarterly Child Care and Development ACF-696 Financial Report (ACF-696 report), which is a cumulative report for the FY.

In Arizona, the State agency is the lead agency. As the lead agency, the State agency is required to oversee the expenditure of funds by providers, contractors, and other agencies of the Arizona State government to ensure that the funds are expended in accordance with Federal requirements. The State agency contracts with these entities to expend the funds.

The State agency considers contractual obligations to have occurred at the signing of the contract. Once a contract is signed and funds are encumbered (money is available and set aside in the accounting system), the State agency is obligated to pay the contracted entity when the service is provided.[1]

HOW WE CONDUCTED THIS REVIEW

We reviewed all of the $29,443,756 of CCDF targeted fund expenditures that the State agency reported on its ACF-696 reports for FYs 2007 through 2009.[2]

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix B contains details of our audit scope and methodology, and Appendix C contains details on the Federal and State requirements related to CCDF targeted funds.

FINDING

Of the $29,443,756 of CCDF targeted fund expenditures that we reviewed, the State agency complied with Federal requirements for the use of $27,199,673. However, the State agency did not comply with Federal requirements for the use of the remaining $2,244,083. Specifically, the State agency improperly obligated $2,244,083 of FY 2009 targeted funds after the obligation period had ended.

The State agency did not have written policies and procedures addressing the monitoring of the obligation and liquidation of the targeted funds. Without necessary policies and procedures, the State agency could not identify which specific expenditures would be allowable for a particular FY.

STATE AGENCY IMPROPERLY OBLIGATED TARGETED FUNDS

Federal regulations specify that CCDF funds must be obligated[3] in the FY in which the funds were awarded or in the succeeding FY and specify that any funds not obligated during this period will revert to the Federal Government (45 CFR §§ 98.60(d)(1) and 98.60(d)(7)). Federal

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[1] The Arizona Revised Statutes, section 35-101.13, define "encumbrance" as "an obligation in the form of any purchase order, contract or other commitment which is chargeable to an appropriation or any other authorized fund source and for which a part of the fund source is reserved. It ceases to be an encumbrance when paid or canceled."

[2] The 3-year obligation and liquidation cycle described above creates a delay in terms of when those funds can be regarded as closed for adjustment and then subject to audit.

[3] The determination of whether funds have been obligated and liquidated will be based on State or local law; if there is no applicable State or local definition, the Federal definitions of "obligations" and "outlays" (expenditures at 45 CFR § 92.3) apply (45 CFR § 98.60(d)(4)).

regulations also specify that fiscal control and accounting procedures must be sufficient to permit the tracing of funds to a level of expenditure adequate to establish that the funds have not been used in violation of the restrictions and prohibitions of the statute authorizing the block grant (45 CFR § 98.67(c)).

Contrary to these Federal requirements, the State agency improperly obligated $2,244,083 in targeted funds. Specifically, the State agency transferred $2,244,083 of lump-sum expenditures to FY 2009 that had been obligated and liquidated with FY 2011 targeted funds. These lump-sum transfers were unallowable because the obligation for these expenditures occurred in FY 2011, which was after the 2-year obligation period for FY 2009 had ended (September 30, 2010). Table 2 shows that the obligation periods for FYs 2009 and 2011 do not overlap.

Table 2: Comparison of Obligation and Liquidation Periods for FYs 2009 and 2011

FY	Obligation Period Start Date	Obligation Period End Date	Liquidation Period End Date
2009	10/1/2008	9/30/2010	9/30/2011
2011	10/1/2010	9/30/2012	9/30/2013

In addition, the State agency could not trace these lump-sum transfers to specific expenditures. The State agency kept journal vouchers that provided general information, such as the lump-sum amount and the grant year that the amount was being transferred to and from. However, these vouchers did not identify the specific expenditures related to the lump-sum transfers.

STATE AGENCY DID NOT HAVE WRITTEN POLICIES AND PROCEDURES ADDRESSING MONITORING OF OBLIGATION AND LIQUIDATION OF TARGETED FUNDS

The State agency had written procedures regarding CCDF targeted funds management but did not have written policies and procedures addressing the monitoring of the obligation and liquidation of the targeted funds. Without necessary policies and procedures, the State agency could not identify which expenditures would be allowable for a particular FY. Better monitoring would have revealed that the targeted funds were not being obligated and liquidated according to the timeframes specified in Federal requirements.

RECOMMENDATIONS

We recommend that the State agency:

- refund to the Federal Government $2,244,083 for CCDF targeted funds that were not properly obligated and liquidated and

- develop and implement policies and procedures to address the monitoring of the obligation and liquidation of CCDF targeted funds to ensure that the funds are properly obligated and liquidated.

STATE AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, the State agency indicated that it would not challenge our finding that it had improperly obligated $2,244,083 of targeted funds. However, the State agency did not concur with our recommendation to refund this amount. The State agency commented that its noncompliance "resulted from an unintentional misunderstanding of the process, rather than willful misrepresentation" on its financial reports. The State agency also commented that the "services claimed were appropriate to be reported against the specified targeted fund but were delivered outside of the timeframe to report for that fiscal year." The State agency provided information on corrective actions that it had taken regarding our finding. The State agency concurred with our other recommendation and provided information on actions that it had taken or planned to take to address this recommendation. The State agency's comments appear in their entirety as Appendix D.

After reviewing the State agency's comments, we maintain that our recommendation to refund $2,244,083 to the Federal Government is valid. As noted in our report, the State agency transferred this amount of lump-sum expenditures to FY 2009 that had been obligated and liquidated with FY 2011 targeted funds. Because the obligation for these expenditures occurred after the obligation period for FY 2009 had ended, these expenditures were unallowable. Federal regulations require that CCDF funds not obligated during the period that they were awarded or in the succeeding FY will revert to the Federal Government.

APPENDIX A: RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Report Title	Report Number	Date Issued
Virginia Properly Obligated and Liquidated Most Targeted Funds Under the Child Care and Development Fund Program	A-03-12-00251	10/17/2013
Louisiana Improperly Claimed Some Child Care and Development Fund Targeted Funds	A-06-12-00057	9/30/2013
Nebraska Improperly Claimed Some Child Care and Development Targeted Funds	A-07-12-03175	4/30/2013
Michigan Properly Obligated and Liquidated Targeted Funds Under the Child Care and Development Fund Program	A-05-12-00062	4/26/2013
Ohio Properly Obligated and Liquidated Targeted Funds Under the Child Care and Development Fund Program	A-05-12-00061	4/26/2013
Connecticut Properly Obligated and Liquidated Targeted Funds Under the Child Care and Development Fund Program	A-01-12-02505	2/21/2013
Iowa Improperly Claimed Some Child Care and Development Targeted Funds	A-07-11-03163	3/28/2012

APPENDIX B: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed all of the $29,443,756 of CCDF targeted fund expenditures that the State agency reported on its ACF-696 reports for FYs 2007 through 2009. We did not perform a detailed review of the State agency's internal controls because our objective did not require us to do so. We limited our review to the controls related to the obligation and liquidation of the targeted funds.

We conducted our audit from September 2012 to October 2013 and performed our fieldwork at the State agency's office in Phoenix, Arizona.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and program guidance, as well as State laws and the approved Arizona CCDF State plans;
- reviewed the ACF-696 reports for FYs 2007 through 2009 to determine the amount of targeted funds that the State agency reported;
- interviewed ACF officials to obtain an understanding of the CCDF program;
- interviewed State agency officials responsible for preparing the ACF-696 reports to obtain an understanding of how the reports were prepared, how the targeted funds were reported, and what documentation was maintained to support expenditures on the reports;
- reconciled expenditures reported on the ACF-696 reports for CCDF targeted funds with the State agency's general ledger;
- analyzed the State agency's general ledger and examined, on a test basis, documentation supporting selected transactions to determine their allowability in relation to obligation and liquidation requirements;
- interviewed State agency officials and reviewed State agency policies and procedures to gain an understanding of CCDF targeted funds management in relation to the obligation, encumbrance, and liquidation requirements;
- reviewed the State agency's contracts with providers, contractors, and other agencies of the Arizona State government to determine the dates on which the contracts were signed in relation to the obligation requirements of targeted funds for FYs 2007 through 2009;
- reviewed invoices submitted to the State agency from providers, contractors, and other agencies of the Arizona State government to determine the dates on which the contracted

services were provided in relation to the obligation requirements of targeted funds for FYs 2007 through 2009;

- reviewed the State agency's dates of payment to providers, contractors, and other agencies of the Arizona State government in relation to the liquidation requirements of targeted funds for FYs 2007 through 2009; and

- shared the results of our review with State agency officials.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C: FEDERAL AND STATE REQUIREMENTS RELATED TO TARGETED FUNDS UNDER THE CHILD CARE AND DEVELOPMENT FUND

FEDERAL REQUIREMENTS

Federal regulations (45 CFR § 98.60(d)(1)) state: "Discretionary Fund allotments shall be obligated in the fiscal year in which funds are awarded or in the succeeding fiscal year. Unliquidated obligations as of the end of the succeeding fiscal year shall be liquidated within one year."

Federal regulations (45 CFR § 98.60(d)(7)) state: "Any funds not obligated during the obligation period specified in paragraph (d) of this section will revert to the Federal government. Any funds not liquidated by the end of the applicable liquidation period specified in paragraph (d) of this section will also revert to the Federal government."

Federal regulations (45 CFR § 98.60(d)(4)) state: "… determination of whether funds have been obligated and liquidated will be based on: (i) State or local law; or, (ii) If there is no applicable State or local law, the regulation at 45 CFR 92.3, Obligations and Outlays (expenditures)."

Federal regulations (45 CFR § 92.3) state: "*Obligations* means the amounts of orders placed, contracts and subgrants awarded, goods and services received, and similar transactions during a given period that will require payment by the grantee during the same or a future period."

Federal regulations (45 CFR § 98.67(c)) state: "Fiscal control and accounting procedures shall be sufficient to permit … [t]he tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of the provisions of this part."

STATE REQUIREMENTS

The Arizona Revised Statutes, section 35-101.13, state: "Encumbrance means an obligation in the form of any purchase order, contract or other commitment which is chargeable to an appropriation or any other authorized fund source and for which a part of the fund source is reserved. It ceases to be an encumbrance when paid or canceled."

APPENDIX D: STATE AGENCY COMMENTS

DEPARTMENT OF ECONOMIC SECURITY

Your Partner For A Stronger Arizona

Janice K. Brewer
Governor

Clarence H. Carter
Director

FEB 20 2014

Ms. Lori A. Ahlstrand
Regional Inspector General for Audit Services
Office of Audit Services, Region IX
90 7th Street, Suite 3-650
San Francisco, California 94103

RE: *Arizona Improperly Claimed Some Child Care and Development Targeted Funds*, Draft Report: A-09-12-010004

Dear Ms. Ahlstrand:

We have reviewed the U.S. Department of Health and Human Services, Office of Inspector General (OIG), January 24, 2014 draft report entitled *Arizona Improperly Claimed Some Child Care and Development Targeted Funds,* and enclosed are comments from the Arizona Department of Economic Security (DES).

DES appreciates the opportunity to respond to and provide additional comments to the draft report, which will be included in the final report. If you have any questions, please contact Brad Willis, Program Administrator, Child Care Administration at (602) 542-1958 or email BWillis@azdes.gov.

Sincerely,

/s/ Clarence H. Carter
Clarence H. Carter
Director

Enclosure

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ARIZONA DEPARTMENT OF ECONOMIC SECURITY
RESPONSE TO OIG DRAFT REPORT

Arizona Improperly Claimed Some Child Care Development Targeted Funds;
Report Number A-09-12-0004

Background

Under the Child Care Development Fund (CCDF) program, States have considerable latitude in administering and implementing their childcare programs. Each State must develop, and submit to the Administration for Children and Families (ACF) for approval, a state plan that identifies the purposes for which CCDF funds will be expended for two grant periods (i.e., two fiscal years). Program requirements state that a state agency has two fiscal years to obligate CCDF funds and a third fiscal year to liquidate those funds. The state plan must also designate a lead agency responsible for administering childcare programs. In addition, states are required to report expenditures of targeted funds on the quarterly Child Care and Development ACF-696 Financial Report (ACF-696 report), which is a cumulative report for the fiscal year.

In Arizona, the Department of Economic Security (DES) is the lead agency. As the lead agency, DES is required to oversee the expenditure of funds by providers, contractors, and other agencies of the Arizona State government to ensure that the funds are expended in accordance with federal requirements. The Office of Inspector General (OIG) reviewed all of the $29,443,756 of CCDF targeted fund expenditures that DES reported on its ACF-696 reports for Fiscal Years 2007 through 2009.

OIG Finding and Recommendation #1

Of the $29,443,756 of CCDF targeted funds expenditures reviewed, DES complied with federal requirements for the use of $27,199,673 (92.4 percent). OIG determined that DES did not comply with federal requirements for the use of the remaining $2,244,083 (7.6 percent). Specifically, OIG concluded that DES improperly obligated $2,244,083 of Fiscal Year 2009 targeted funds after the obligation period had ended.

OIG recommends that DES:

- Refund to the federal government $2,244,083 for CCDF targeted funds that were not properly obligated and liquidated.

DES Response to Finding and Recommendation #1

DES will not challenge the referenced finding, but does not concur with the recommendation that DES refund the federal government $2,244,083.

DES is cognizant of the requirement that discretionary funds be obligated in the fiscal year in which they are received, or in the succeeding fiscal year and liquidated by the end of the third federal fiscal year.

- The identified non-compliance with obligation/liquidation periods resulted from an unintentional misunderstanding of the process, rather than willful misrepresentation on financial reports submitted to Department of Health and Human Services (DHHS).
- The services claimed were appropriate to be reported against the specified targeted fund but were delivered outside of the timeframe to report for that fiscal year.
- DES has enhanced its process for lump-sum adjustments in which detailed supporting documentation is necessary prior to the documents being processed.
- DES has also instituted enhancements to the payment system which will allow for increased oversight and monitoring of grant obligation and liquidation periods for targeted funds.

OIG Finding and Recommendation #2

DES did not have written policies and procedures addressing the monitoring of the obligation and liquidation of the targeted funds. Without necessary policies and procedures, DES could not identify which specific expenditures would be allowable for a particular fiscal year.

OIG recommends that DES:

- Develop and implement policies and procedures to address the monitoring of the obligation and liquidation of CCDF targeted funds to ensure that the funds are properly obligated and liquidated.

DES Response to Finding and Recommendation #2

DES concurs with the referenced finding and recommendation.

To address this finding, DES has taken and will take the following action:

- DES has implemented procedures to comply with a more restrictive threshold for establishment of encumbrances for targeted funds.
- The DES Child Care Administration, and the Division of Rehabilitation Services Finance and Budget Unit (FBU) and the Financial Services Administration (FSA) will ensure the proper management of oversight of targeted funds to remain within CCDF grant targeted encumbrance and spending requirements. Specifically, the Division of Rehabilitation Services will provide a senior management review and approval of all expenditures or adjustments of requests moving expenditures which may result in reporting expenditures that occur outside the obligation period to ensure formal compliance with encumbrance requirements.
- Expenditures reported for disbursements after the obligation period will be avoided. If any such expenditure is reported, detailed expenditure data containing the original date of service and activity will be maintained by the Division of Employment and Rehabilitation Services.