



Office of Audit Services, Region III  
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Philadelphia, PA 19106-3499

**JUN 22 2006**

**TO:** David J. Lett  
Regional Administrator  
Administration for Children and Families, Region III

**FROM:** Regional Inspector General for Audit Services

**SUBJECT:** Audit of Head Start Costs for Fiscal Year Ending June 30, 2005 for  
Arlington Community Action Program, Inc. (A-03-05-00551)

Attached are two copies of the U.S. Department of Health and Human Services, Office of Inspector General final report entitled "Audit of Head Start Costs for Fiscal Year Ending June 30, 2005 for Arlington Community Action Program, Inc." In response to a request made by the Administration for Children and Families (ACF), we audited the costs claimed for the Head Start program awarded to Arlington Community Action Program, Inc. (ACAP) under Head Start grant No. 03CH2126/39.

We discussed our audit findings with ACAP officials throughout the course of the audit. At ACF's request, we are issuing our report in final directly to the Region III Regional Administrator for ACF.

We would appreciate your views and the status of any actions taken or contemplated on our recommendations within 60 days. If you have any questions, please contact me or have your staff contact Bert Anker, Audit Manager, at (301) 443-9765 or through e-mail at [bert.anker@oig.hhs.gov](mailto:bert.anker@oig.hhs.gov).

Please refer to report number A-03-05-00551 in all correspondence relating to this report.

A handwritten signature in black ink, appearing to read "Stephen Virbitsky".

Stephen Virbitsky

Attachment

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF HEAD START COSTS  
FOR FISCAL YEAR ENDING  
JUNE 30, 2005 FOR  
ARLINGTON COMMUNITY  
ACTION PROGRAM INC.**



Daniel R. Levinson  
Inspector General

June 2006  
A-03-05-00551

# *Office of Inspector General*

<http://oig.hhs.gov>

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## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.





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**TO:** David J. Lett, Regional Administrator  
Administration for Children and Families, Region III

**FROM:** Regional Inspector General for Audit Services

**SUBJECT:** Audit of Head Start Costs for Fiscal Year Ending June 30, 2005 for Arlington Community Action Program, Inc. (A-03-05-00551)

The purpose of this report is to provide you with the final results of our audit of Head Start grant No. 03CH2126/39 awarded by the Administration for Children and Families (ACF) to Arlington Community Action Program, Inc. (ACAP) for the period July 1, 2004, through June 30, 2005. The objective of the audit was to determine whether the costs ACAP claimed for the Head Start program were allowable under the terms of the grant, applicable Federal regulations, and Office of Management and Budget (OMB) guidance.

ACF awarded ACAP a grant totaling \$2,062,097 to operate the Head Start program during the grant period. Of the amount awarded, ACAP claimed \$2,045,109 in costs related to the Head Start program. We determined that \$1,525,073 of the \$2,045,109 claimed was allowable. Of the remaining \$520,036, we did not accept \$342,004 and recommend that it be refunded to ACF and set aside \$178,032 for ACF's adjudication (See appendix).

We discussed our findings with ACAP officials throughout the course of the audit. At ACF's request, we are issuing our report in final directly to ACF's Region III, Regional Administrator.

We recommend that ACF:

1. request that ACAP refund \$342,004 in costs that were either unallowable or unsupported and
2. make a determination on the acceptance of \$178,032 of set aside costs that did not have sufficient supporting records for us to determine allowability.

## BACKGROUND

Head Start is a discretionary grant program enacted under Title V of the Economic Opportunity Act of 1964 and is administered by ACF within the U.S. Department of Health and Human Services (HHS) pursuant to 45 CFR § 74. Major program objectives include:

- promoting school readiness by enhancing the social and cognitive development of low-income children through the provision of comprehensive health, education, nutrition, social, and other services;

- involving parents in their children’s learning; and
- helping parents make progress toward educational, literacy, and employment goals.

ACAP is a Head Start grantee for Arlington County, Virginia. ACAP, incorporated over 38 years ago, serves 293 children within the county. Classes for the Head Start program are held in four locations throughout Arlington County.

A March 2004 Head Start Program Review Instrument System Monitor (PRISM) review, which ACF routinely performs every 3 years, disclosed fiscal findings at ACAP in the areas of procurement procedures and program governance. In April 2005, a follow-up PRISM review revealed that ACAP was in compliance with the procurement procedures but still had outstanding issues in the area of program governance. Also, during the follow-up review, ACF learned that ACAP had terminated the fiscal director for failing to implement sound fiscal policies and procedures. In addition to being deficient in the previous fiscal findings, the follow-up review disclosed several newly identified fiscal areas of noncompliance, including standards for financial management systems, payments, equipment, financial reporting, human resources management, reasonableness, and report submission. The newly identified areas of noncompliance prompted ACF to conduct a further examination of ACAP’s financial practices.

Effective June 3, 2005, ACF designated ACAP as a high-risk organization for failure to maintain proper internal controls to safeguard Head Start assets. A high-risk organization is one whose management practices raise serious questions about its ability to assure proper programmatic use and financial stewardship of grant funds. Further, ACF requested that ACAP provide an accounting system certification as provided for in 45 CFR § 1301.13. The regulations require a Head Start grantee to submit an accounting system certification, prepared by an independent auditor, stating that the accounting system or systems established by the Head Start grantee has appropriate internal controls for safeguarding assets, checking the accuracy and reliability of accounting data, and promoting operating efficiency. ACAP provided ACF the required accounting system certification on August 26, 2005.

On July 21, 2005, the Region III Regional Administrator for ACF requested that the Office of Inspector General (OIG) conduct a review of the financial management practices at ACAP. Specifically, the Regional Administrator wanted to know whether or not ACAP was using Head Start funds to cover costs for functions other than Head Start. Further, the Regional Administrator wanted to know if there was any indication of potential fraud and abuse associated with the financial management practices at ACAP.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

The objective of the audit was to determine whether the costs ACAP claimed for the Head Start program were allowable under the terms of the grant, applicable Federal regulations, and OMB guidance. We also focused on whether ACAP:

- had adequate financial management practices,
- committed fraud and abuse in association with its financial management practices, and
- used Head Start funds to cover costs for functions other than Head Start.

## **Scope**

We judgmentally sampled \$806,039 of the \$2,045,109 ACAP claimed under the Head Start program from July 1, 2004, through June 30, 2005. The audit did not include an assessment of ACAP's compliance with the performance requirements for Head Start programs. However, we believe that the procedures we performed provide a reasonable basis for our findings and recommendations. We performed our audit at ACAP from August 2005 through March 2006.

## **Methodology**

In performing this audit, we:

- held discussions with ACF and ACAP officials to obtain information about the Head Start program;
- reviewed the results of ACF's March 2004 PRISM review and April 2005 PRISM follow-up review;
- reviewed letters from ACF to ACAP and ACAP to ACF in response to the results of the PRISM reviews;
- reviewed applicable Federal laws, regulations, and guidelines, including the OMB Circulars A-110, "Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," OMB Circular A-122, "Cost Principles for Non-Profit Organizations," and OMB A-133, "Audits of States, Local Governments, and Non-Profit Organizations;"
- reviewed ACAP's grant related documents, including the Head Start grant applications, Financial Assistance Awards, Financial Status Reports (SF 269), Requests for Advance Payments (SF 270), and Federal Cash Transaction Reports (PSC 272);
- reviewed ACAP's internal documents, including certification of incorporation, organizational chart, listing of the locations associated with the Head Start program, listing of the staff for ACAP and the Head Start program, financial management and personnel policies and procedures;

- reviewed ACAP's independent audit reports and related financial statements for the fiscal years ending June 30, 2004, 2003, and 2002;
- reviewed the independent audit report pertaining to the certification of ACAP's accounting system;
- examined ACAP's internal controls over its account receivables, account payables, and inventories for equipment, supplies and vehicles;
- reconciled the costs ACAP claimed to its accounting records;
- selected a judgmental sample of ACAP's personnel costs (salaries and wages, leave allocation, and fringe benefits) and non-personnel costs (travel, supplies, and other direct costs) for detailed review;
- reviewed ACAP's documents from the Internal Revenue Service (IRS) pertaining to ACAP's unpaid payroll taxes<sup>1</sup> for fiscal year 2005;
- reviewed ACAP's indirect cost rate agreement negotiated with HHS and analyzed ACAP's indirect costs; and
- discussed our findings with ACAP officials throughout the course of the audit.

We performed our review in accordance with generally accepted government auditing standards.

### **FINDINGS AND RECOMMENDATIONS**

ACAP claimed \$2,045,109 in costs related to the Head Start program for the grant year ended June 30, 2005. We judgmentally sampled \$806,039 of the \$2,045,109 claimed. We did not accept \$342,004 and recommend that it be refunded to ACF and set aside \$178,032 for ACF's adjudication as follows.

1. We did not accept \$342,004 in claimed costs that were either unsupported or represented unallowable Head Start costs (See appendix).
2. We set aside \$178,032 in claimed costs for ACF's adjudication because of insufficient documentation (See appendix).

Further, we noted that ACAP did not have adequate financial management practices to support Head Start costs as required by Federal regulations. Specifically, ACAP did not maintain segregation of duties over its accounting functions; did not timely record costs charged against the grant; did not always document the methodology used to allocate certain costs; did not maintain adequate documentation to validate the costs claimed; and did not have effective control over and accountability for all funds, property, and other assets. ACAP officials

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<sup>1</sup> The unpaid payroll taxes included Federal income taxes, Social Security taxes, and Medicare taxes.

attributed these findings to the former fiscal director's failure to implement sound fiscal policies and procedures.

Although we found instances of noncompliance with the terms of the grant, applicable Federal regulations, and OMB guidance, which included ACAP using Head Start funds to cover costs for functions unrelated to the Head Start program, we did not detect any fraud and abuse in ACAP's financial management practices.

On March 27, 2006, ACAP officials informed OIG that the Head Start grant for the fiscal year beginning July 1, 2006, would be relinquished and ACAP will be dissolved as a non-profit organization effective June 30, 2006.

### **UNALLOWABLE AND UNSUPPORTED COSTS**

From the costs ACAP claimed under the Head Start program, we reviewed supporting documentation for a judgmental sample of transactions totaling \$806,039. Of this amount:

- We did not accept, and recommend for refund, \$342,004 in unallowable or unsupported costs, such as salaries and wages unrelated to the Head Start program; payroll taxes (Federal, Social Security, and Medicare) withheld from the Head Start employees, but not submitted to IRS, expenses for travel that exceeded the allowable per diem amount, expenses for purchases made prior to or after the grant period, and expenses for food supplies covered by another Federal grant.
- We set aside for ACF's adjudication \$178,032 in costs for which ACAP had supporting documentation, such as payment vouchers, invoices, check stubs, and canceled checks, but no purchase requisitions, purchase orders, travel vouchers with receipts, method for allocating certain expenses, or delivery receipts for goods and services purchased to determine whether the costs were properly authorized, reasonable, allocable, received or used for the Head Start program.
- We accepted \$286,003 as allowable and supported costs under the terms of the grant, applicable Federal regulation, and OMB guidance.

### **RECOMMENDATIONS**

We recommend that ACF:

1. request that ACAP refund \$342,004 in costs that were either unallowable or unsupported and
2. make a determination on the acceptance of \$178,032 of set aside costs that did not have sufficient supporting records for us to determine allowability.

If you have any questions or comments about this report, please do not hesitate to contact me at (215) 861-4470 (e-mail [stephen.virbitsky@oig.hhs.gov](mailto:stephen.virbitsky@oig.hhs.gov)), or your staff may contact Bert Anker, Audit Manager, at (301) 443-9765 (e-mail [bert.anker@oig.hhs.gov](mailto:bert.anker@oig.hhs.gov)). Please refer to report number A-03-05-00551 in all correspondence.

A handwritten signature in black ink, appearing to read "Stephen Virbitsky". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Stephen Virbitsky

# **APPENDIX**

**STATEMENT OF COSTS CLAIMED AND AUDITOR'S RELATED  
RECOMMENDATION  
ARLINGTON COMMUNITY ACTION PROGRAM, INC.  
ARLINGTON, VIRGINIA  
HEAD START GRANT NO. 03CH2126  
FISCAL YEAR ENDING JUNE 30, 2005**

<b>Cost Categories</b>	<b>Claimed</b>	<b>Accepted</b>	<b>(*) Not Accepted</b>	<b>(*) Set Aside for Adjudication</b>	<b>Notes</b>
Salaries and Wages	\$1,135,106	\$1,053,765	\$69,801	\$11,539	<b>1</b>
Leave Allocation	153,025	142,269	10,755	0	<b>2</b>
Fringe Benefits	143,346	78,083	65,263	0	<b>3</b>
Travel	14,191	7,685	5,502	1,005	<b>4</b>
Supplies	70,778	12,624	30,254	27,901	<b>5</b>
Other Direct	248,313	50,046	62,422	135,845	<b>6</b>
Indirect Costs	280,350	180,601	98,007	1,742	<b>7</b>
<b>Total</b>	<b>\$2,045,109</b>	<b>\$1,525,073</b>	<b>\$342,004</b>	<b>\$178,032</b>	

(\*) Our determination for not accepting and setting aside costs was based on Office of Management and Budget (OMB) Circular A-122 and Office of Inspector General, Office of Audit Services (OAS) Policies and Procedures Manual. OMB Circular A-122 states that, to be allowable under an award, costs must be reasonable, allocable and adequately documented.

In accordance with the OAS manual, the term "set aside costs" is used because we lack adequate documentation to support costs claimed under the grant, and we could not make a determination as to the allowability of those costs. Accordingly, we set aside those costs for future resolution between Administration for Children and Families (ACF) and Arlington Community Action Program, Inc. (ACAP). For details, please see the accompanying notes.

**NOTES****1. Salaries and Wages**

We judgmentally sampled the salaries and wages claimed under the Head Start program for 27 individuals. The sample included:

- 20 individuals who were paid the highest salaries and wages;
- 5 individuals who were paid after they had resigned or were terminated; and
- 2 individuals who were not Head Start employees, but were paid under the program.

Further, we identified the amount of the Federal income taxes withheld from the salaries and wages of all the individuals paid under the Head Start program from July 2004 to March 2005, that was not paid to the Internal Revenue Service (IRS).

We did not accept and recommend for refund salaries and wages totaling \$69,801. This amount represented \$8,565 in salaries and wages for 25 employees that were either unallowable based on ACAP's personnel policies and procedures or unsupported; \$2,375 in salaries and wages for 2 employees that were unrelated to the Head Start program; and \$58,861 in Federal income taxes that ACAP withheld from the individuals paid under the Head Start program, but did not submit to IRS.

We also set aside \$11,539 in salaries and wages for ACF's adjudication. This amount represented salaries and wages claimed for 10 employees, for which ACAP did not have sufficient supporting documentation for us to validate the method it used to allocate the costs to the Head Start program.

**2. Leave Allocation**

We judgmentally sampled the leave allocation costs claimed under the Head Start program for the 20 individuals who were paid the highest salaries and wages. The leave allocation represented costs for paid absences, which included annual leave, sick leave, holidays, jury duty, maternity leave, military leave, family and medical leave, and bereavement leave.

We did not accept and recommend for refund leave allocation costs totaling \$10,755. This amount consisted of \$2,534 in leave allocation for 12 employees that was either unallowable based on ACAP's personnel policies and procedures or unsupported; and \$8,221 in leave allocation that was overstated based on the supporting payroll records.

### **3. Fringe Benefits**

We identified the amount of the social security and Medicare taxes withheld from the salaries and wages for all the individuals paid under the Head Start program from July 2004 to March 2005, that were not paid to IRS.

We did not accept and recommend for refund fringe benefits totaling \$65,263. This amount represented the Social Security and Medicare taxes that ACAP withheld from the individuals paid under the Head Start program, but did not submit to IRS. Generally, IRS requires the employer to pay a matching amount of the social security and Medicare taxes withheld from its employees. However, we did not find any records showing that ACAP paid IRS or claimed under Head Start the employer's share of the Social Security and Medicare taxes.

### **4. Travel**

We judgmentally sampled the travel costs claimed under the Head Start program for 17 transactions. The sample included:

- 1 transaction in costs claimed for local travel and
- 16 transactions in costs claimed for out of town travel.

We did not accept and recommend for refund travel costs totaling \$5,502. This amount was comprised of \$326 in local travel for the payments of hotel lodging that was unsupported; and \$5,176 in out of town travel for the payments of airline tickets, hotel lodging and meals that were either unrelated to the Head Start program, exceeded the per diem amount allowable, unsupported, or represented duplicate claimed costs.

We also set aside \$1,005 in travel costs for ACF's adjudication. This amount represented out of town travel for payments of an airline ticket and hotel lodging, for which ACAP did not have adequate supporting documentation. ACAP claimed \$202 in a non-refundable airline ticket for one employee who, according to its officials, was unable to attend a scheduled conference and was given approval by ACF officials not to refund the cost of the airline ticket. Further, ACAP claimed \$803 in hotel lodging for one employee, but could not provide a travel voucher with the necessary receipts to validate the costs claimed.

### **5. Supplies**

We judgmentally sampled the supply costs claimed under the Head Start program for 15 transactions. The sample included:

- 3 transactions in costs claimed for food supplies;
- 3 transactions in costs claimed for medical and dental supplies;

- 5 transactions in costs claimed for program supplies; and
- 4 transactions in costs claimed for office and computer supplies.

We did not accept and recommend for refund supply costs totaling \$30,254. This amount consisted of \$24,221 in food supplies that were paid under another Federal grant; \$5,933 in program supplies for a playground set and magazine subscription that were purchased outside the grant period; and \$100 in office and computer supplies for a personalized desk-top set that was unsupported.

We also set aside \$27,901 in supply costs for ACF’s adjudication. This amount represented \$635 in medical and dental supplies, \$25,862 in program supplies, and \$1,404 in office and computer supplies, for which ACAP did not provide adequate supporting documentation. ACAP provided payment vouchers, invoices, check stubs, and canceled checks, but no purchase requisitions, purchase orders, or delivery receipts for goods and services purchased to determine the allowability of the costs claimed.

**6. Other Direct**

We judgmentally sampled the other direct costs claimed under the Head Start program for 88 transactions (as shown below).

We did not accept and recommend for refund other direct costs totaling \$62,422. This amount was comprised of \$57,162 in other direct costs that was mostly unsupported (as shown below); and \$5,260 in other direct costs that was overstated based on the supporting general ledger.

We also set aside \$135,845 in other direct costs for ACF’s adjudication. This amount represented other direct, for which ACAP did not provide adequate supporting documentation (as shown below). ACAP claimed a majority of the costs for contractual services, for which it did not obtained the most reasonable costs for the service. Further, ACAP had several buses for the Head Start program that it did not use because of lack of drivers, but made no efforts to secure bus drivers before contracting the bus services.

<b>Other Direct</b>	<b>Transactions</b>	<b>Costs Not Accepted</b>	<b>Costs Set Aside</b>
Advertising	3	\$268	\$1,745
Consulting Services	5	56	4,224
Contractual Services	6	30,256	118,169
Equipment Leasing	3	100	2,364
Equipment Purchasing	8	5,154	0
Field Trips	1	300	0
Membership Fees	1	250	0
Other Costs	20	3,611	5,026
Parent Services	7	1,220	50

Other Direct	Transactions	Costs Not Accepted	Costs Set Aside
Postage	1	24	0
Registration Fees	7	2,475	0
Space Rental	3	0	3,453
Storage Fees	7	2,662	400
Telephone	13	6,461	414
Vehicle Gas	3	4,327	0
Costs Overstated	0	5,260	0
<b>Total</b>	<b>88</b>	<b>\$62,422</b>	<b>\$135,845</b>

## 7. Indirect Costs

We computed indirect costs based on the salaries and wages, leave allocation, and the approved indirect cost rate. We compared the indirect costs computed to the indirect costs claimed. Further, we computed the amount of the indirect costs not accepted and set aside based on the salaries and wages and leave allocation that were not accepted and set aside for ACF's adjudication.

We did not accept and recommend for refund indirect costs totaling \$98,007. This amount was comprised of \$12,164 in indirect costs related to salaries and wages and leave allocation that were not accepted (**\$80,558 x 15.1 percent approved indirect cost rate**); and \$85,843 in indirect costs that was over claimed because ACAP used an indirect cost rate (**22 percent**) that was higher than the approved indirect cost rate.

We also set aside \$1,742 in indirect costs for ACF's adjudication. This amount represented indirect costs related to the salaries and wages that were set aside for ACF's adjudication (**\$11,539 x 15.1 percent approved indirect cost rate**).

## ACKNOWLEDGMENTS

This report was prepared under the direction of Stephen Virbitsky, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff that contributed includes:

Bert Anker, *Audit Manager*

Lisa Blake, *Senior Auditor*

Julian Murray, *Auditor*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.