Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

TEACHING & MENTORING COMMUNITIES CLAIMED UNALLOWABLE HEAD START COSTS

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

Patricia Wheeler
Regional Inspector General
for Audit Services

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A-06-14-00036

Office of Inspector General

http://oig.hhs.gov

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EXECUTIVE SUMMARY

Teaching & Mentoring Communities claimed $634,958 in Head Start costs that were unallowable under Federal regulations and the terms of the grants.

WHY WE DID THIS REVIEW

Oversight and management of grant programs is crucial to the U.S. Department of Health and Human Services' (HHS) mission and to the health and well-being of the public. Audits of Head Start and other HHS grantees have found internal control deficiencies, problems with financial stability, inadequate organizational structures, inadequate procurement and property management policies, and inadequate personnel policies and procedures.

The objective of this review was to determine whether Teaching & Mentoring Communities (TMC) claimed Head Start costs that were allowable under applicable Federal rules and the terms of grants that it was awarded.

BACKGROUND

Title VI of the Omnibus Budget Reconciliation Act of 1981 established Head Start as a Federal discretionary grant program. The Head Start program provides grants to local public and private for-profit and not-for-profit agencies to provide comprehensive child development services to economically disadvantaged children and families. The program's focus is on helping preschoolers develop the early reading and math skills they need to be successful in school. In 1994, the Head Start program was expanded to establish Early Head Start, which serves children from birth to age 3, to promote prenatal care, enhance the development of infants and toddlers, and promote the healthy functioning of families. Migrant Seasonal Head Start (MSHS) provides services to the children of low-income migrant and seasonal farmworkers.

Within HHS, the Administration for Children and Families (ACF), Office of Head Start (OHS), administers the Head Start program.

TMC, based in Laredo, Texas, operates as a nonprofit human services organization that provides comprehensive Head Start programs. For fiscal years 2013 and 2014, OHS provided MSHS, Head Start, and Early Head Start funds to TMC totaling $143 million. Of the $143 million claimed, we limited our review to $92 million of those costs. TMC also received pass-through funds from other Federal sources for non-Head Start youth programs, such as the Child Care Food Program and the Child Care Development Fund.

WHAT WE FOUND

Of the $92,004,855 in Head Start costs that we reviewed, TMC claimed $91,369,897 that was allowable under applicable Federal rules and the terms of grants that it was awarded. However, the remaining $634,958 was unallowable and consisted of:

- $616,898 in health insurance costs that TMC overcharged,

- $15,750 in unsupported consulting costs, and

- $2,310 in membership costs that did not have prior approval.

In addition, TMC did not have adequate controls over its financial management system. Specifically, TMC did not ensure that all costs were supported by adequate documentation and did not always have a board of directors representative with fiscal management or accounting experience.

TMC claimed the unallowable costs because management overcharged employee insurance premium costs and did not ensure that only allowable costs were charged to the award.

WHAT WE RECOMMEND

We recommend that TMC:

- refund to the Federal Government $616,898 for health insurance costs that were overcharged,

- refund to the Federal Government $15,750 in unsupported consulting costs,

- refund to the Federal Government $2,310 in costs for memberships that did not have prior approval,

- develop and implement procedures to review and pay the actual costs of fringe benefits,

- ensure that all consulting costs are supported by adequate supporting documentation,

- ensure that prior approval is obtained from ACF before charging any cost for memberships to the award, and

- ensure that a fiscal management or accounting representative who is knowledgeable of Federal Head Start requirements is on the board of directors.

TEACHING AND MENTORING COMMUNITIES COMMENTS AND OUR RESPONSE

In written comments on our draft report, TMC concurred with our findings related to the $616,898 health insurance overpayment, the $15,750 unsupported contract payments, and the $2,310 unallowable membership costs and detailed steps it has taken to address each recommendation. Although TMC acknowledged that it was not in compliance with Federal regulations when it did not have an individual with accounting expertise on the board of directors, it stated that there were mitigating factors related to the finding that the board of directors lacked oversight when it transferred $275,000 from the health insurance fund to the general fund. We maintain that our findings and recommendations are valid as written.

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INTRODUCTION

WHY WE DID THIS REVIEW

Oversight and management of grant programs is crucial to the U.S. Department of Health and Human Services' (HHS) mission and to the health and well-being of the public. Audits of Head Start and other HHS grantees have found internal control deficiencies, problems with financial stability, inadequate organizational structures, inadequate procurement and property management policies, and inadequate personnel policies and procedures.

OBJECTIVE

Our objective was to determine whether Teaching & Mentoring Communities (TMC) claimed Head Start costs that were allowable under applicable Federal rules and the terms of grants that it was awarded.

BACKGROUND

Head Start Program

Title VI of the Omnibus Budget Reconciliation Act of 1981 established Head Start as a Federal discretionary grant program. The major program objectives include promoting school readiness and enhancing the social and cognitive development of children from families with low incomes by providing educational, health, nutritional, and social services. In 1994, the Head Start program was expanded to establish Early Head Start, which serves children from birth to age 3, to promote prenatal care, enhance the development of infants and toddlers, and promote the healthy functioning of families. In 2007, the Head Start program was reauthorized with significant revisions, including the addition of the Migrant and Seasonal Head Start (MSHS) program.[1] MSHS provides services to the children of low-income migrant and seasonal farmworkers who travel frequently. The MSHS program includes extended program hours and may be in operation from 3 to 10 months at a time. We refer collectively to these programs as the Head Start program.

Within HHS, the Administration for Children and Families (ACF), Office of Head Start (OHS), administers the Head Start program. During Federal fiscal years (FYs) 2013 and 2014, Congress appropriated $16.2 billion to fund Head Start's general operations.

Teaching & Mentoring Communities

TMC, based in Laredo, Texas, operates as a nonprofit human services organization that provides comprehensive Head Start programs in Texas, Wisconsin, Ohio, Oklahoma, Nevada, Iowa, New Mexico, and Indiana. TMC is funded primarily through Federal and State Government grants. For TMC's FYs 2013 and 2014,[2] OHS provided Head Start funds to TMC totaling $143.1

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[1] P.L. No. 110-134, Improving Head Start for School Readiness Act of 2007.

[2] TMC's FYs end on January 31 of the FY.

million. TMC also received pass-through funds from other Federal sources for non-Head Start youth programs, such as the Child Care Food Program and the Child Care Development Fund.

HOW WE CONDUCTED THIS REVIEW

We reviewed $92,004,855 of Head Start costs that TMC claimed during the audit period of February 1, 2012, through January 31, 2014. These costs included $77,306,008 in payroll and indirect costs; $14,062,862 in health insurance fund costs; and a nonstatistical sample of 92 transactions totaling $635,985 for credit card payments, inventory purchases, contracted work, and memberships. We based our sample selections on a risk analysis that was performed based on our review of a list of ACF concerns, an ACF triennial report, and other external audit reports.

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 A contains the details of our audit scope and methodology.

FINDINGS

Of the $92,004,855 in Head Start costs that we reviewed, TMC claimed $91,369,897 that was allowable under applicable Federal rules and the terms of grants that it was awarded. However, the remaining $634,958 was unallowable and consisted of:

- $616,898 in health insurance costs that TMC overcharged,
- $15,750 in unsupported consulting costs, and
- $2,310 in membership costs that did not have prior approval.

In addition, TMC did not have adequate controls over its financial management system. Specifically, TMC did not ensure that all costs were supported by adequate documentation and did not always have a board of directors representative with fiscal management or accounting experience.

TMC claimed the unallowable costs because management overcharged employee insurance premium costs and did not ensure that only allowable costs were charged to the award.

TEACHING & MENTORING COMMUNITIES CLAIMED UNALLOWABLE HEALTH INSURANCE COSTS

To be allowable under an award, costs must be reasonable for the performance of the award and be allocable to the actual cost objective (2 CFR part 230, App. A, § A.4.5). In addition, Federal rules prohibit grantees from using Federal funds to pay any part of the compensation of an individual employed by Head Start if the compensation exceeds the pay rate of a level II executive (42 U.S.C. § 9848(b)(1)). Also, "[a]ny cost allocable to a particular award ... may not be shifted to other Federal awards to overcome funding deficiencies ..." (2 CFR part 230, App. A., § A.4.b).

TMC overcharged OHS Head Start grants $616,898 for health insurance by charging Head Start $14,062,862 in premiums although the actual cost of the premiums was $13,445,964. TMC collected $2,221,060 in insurance premiums from Head Start employees through their payroll deductions and $11,841,802 from Head Start grants through grant drawdowns.

TMC increased the cost of health insurance premiums by multiplying the actual cost of those premiums by a percentage based on the type of plan employees chose. The CFO then provided the payroll and human resources departments with the higher rates to enter into the payroll system, and the payroll department charged Head Start grants and employees those rates.

TMC established a health insurance fund in which it placed the health insurance premiums[3] it collected from its grants and employees before paying the insurance premiums. The CFO transferred the surplus health insurance funds to the general fund and other programs and paid costs that would have been unallowable had they been charged directly to the Federal grants. The board of directors approved some of the transfers to the general fund.

The following are examples of unallowable uses of the surplus health insurance funds:

- During FY 2013, TMC paid the chief executive officer's salary of $224,472, which exceeded the Federal cap of $179,700.[4]

- TMC transferred $294,665 to one of its Head Start grants to make up a portion of $628,022 in cash shortages in FY 2014 caused by over-expending the grant.

- TMC repaid $14,865 to ACF for failing to timely obligate and liquidate funds from an American Recovery and Reinvestment Act Head Start grant.

TMC claimed the unallowable costs because management overcharged employee insurance costs and did not ensure that only allowable costs were charged to the award

TEACHING & MENTORING COMMUNITIES CLAIMED OTHER UNALLOWABLE COSTS

Contract Costs Were Not Supported

Grantees must maintain accurate accounting records, including cost accounting records, that are supported by source documentation (45 CFR § 74.21(b)(7)).

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[3] The premiums were for health, dental, vision care, life, and disability insurance.

[4] The Office of Personnel Management capped level II executive compensation at $179,700 for Federal FY 2013.

TMC claimed $15,750 for a consulting contract for school readiness that was not supported by adequate documentation. TMC hired its former director of children and families as a consultant on February 13, 2012, 3 days after he resigned from his position. TMC provided invoices that listed "School Readiness Consulting Services" as the description of work. However, the invoices did not detail the services that were performed, and TMC was unable to provide adequate support showing that the work had been done. TMC's CFO stated that his staff had requested more supporting documentation from the consultant but that the consultant did not respond.

Membership Costs Lacked Prior Approval

Costs of memberships in civic or community organizations are allowable with prior approval by the cognizant Federal agency (2 CFR part 230, Attachment B, § 30(c)). TMC charged $2,310 to the Head Start award for memberships to various chamber of commerce organizations, totaling $2,160 in FY 2013 and $150 in FY 2014. TMC did not request prior approval for the membership costs. TMC officials said that the cost of memberships should not have been claimed.

TEACHING & MENTORING COMMUNITIES' BOARD OF DIRECTORS LACKED OVERSIGHT

Section 642(c)(1)(B) of the Head Start Act requires that a Head Start agency establish and maintain a formal structure for program governance that includes a governing body composed of, among other required members, at least one member with "a background and expertise in fiscal management or accounting."

TMC did not have the required fiscal management or accounting representative on the board from September 14, 2012, through August 8, 2013. During the January 12, 2013, board meeting, while the accounting representative position was vacant, TMC's board approved the transfer of $275,000 from the health insurance fund to the general fund. The CFO told the board that TMC did not have enough money to cover expenses that were to be paid from the general fund and that there were "… two choices: transfer some money if we have some available in a nonrestricted account or put out audited financials with a huge loss in the General Fund which will raise questions for all of our programs when they review our audit."

RECOMMENDATIONS

We recommend that TMC:

- refund to the Federal Government $616,898 for health insurance costs that were overcharged,
- refund to the Federal Government $15,750 in unsupported consulting costs,
- refund to the Federal Government $2,310 in costs for memberships that did not have prior approval,

- develop and implement procedures to review and pay the actual costs of fringe benefits,
- ensure that all consulting costs are supported by adequate supporting documentation,
- ensure that prior approval is obtained from ACF before charging any cost for memberships to the award, and
- ensure that a fiscal management or accounting representative who is knowledgeable of Federal Head Start requirements is on the board of directors.

TEACHING & MENTORING COMMUNITIES COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

TEACHING & MENTORING COMMUNITIES COMMENTS

In written comments on our draft report, TMC concurred with our findings related to the $616,898 health insurance overpayment, the $15,750 unsupported contract payments, and the $2,310 unallowable membership costs and detailed steps it has taken to address each recommendation. Although TMC acknowledged that it was not in compliance with Federal regulations when it did not have an individual with accounting expertise on the board of directors, it stated that there were mitigating factors related to the finding that the board of directors lacked oversight when it transferred $275,000 from the health insurance fund to the general fund.

Regarding the mitigating factors related to our finding that the board of directors failed to provide proper oversight, TMC stated that, relying on the advice of finance staff that the health insurance fund contained "nonrestricted" funds, the board of directors authorized the transfer. TMC stated: "Had the board been aware that the health insurance fund monies were not, in fact, 'nonrestricted,' it is at best questionable whether it would have allowed the transfer."

TMC stated that shortly after the decision to tap the health insurance fund to cover the general fund deficit, the board of directors became concerned about the advice it was receiving from senior management and hired an independent forensic accounting firm to look into allegations of improper actions by executive staff. TMC further stated that the independent accounting firm identified the transfers from the health insurance funds to the general fund as questionable and that it was the governing board's exercise of its oversight powers that uncovered some or all of the improprieties found by OIG.

OFFICE OF INSPECTOR GENERAL RESPONSE

We did not evaluate whether or not the board relied on the advice from TMC's financial staff regarding the transfer of the $275,000 from the health insurance fund to the general fund. We maintain that the vacancy of the fiscal management or accounting representative limited the ability of the board to effectively oversee the financial/accounting decisions of the organization.

We agree that the board of directors' request to engage the services of an independent accounting firm to look into allegations of improper actions provided some insight into the issues at TMC; however, our audit was based on a risk analysis that was performed on our review of a list of ACF's concerns, a triennial report, and other external audit reports, which included TMC's independent accounting firm audit.

We maintain that our findings and recommendations are valid as written.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

We reviewed $92,004,855 of Head Start costs that TMC claimed during the audit period of February 1, 2012, through January 31, 2014. These costs included $77,306,008 in payroll and indirect costs; $14,062,862 in health insurance fund costs; and a nonstatistical sample of 92 transactions totaling $635,985 for credit card payments, inventory purchases, contracted work, and memberships. We based our sample selections on a risk analysis that was performed based on our review of a list of ACF concerns, a triennial report, and other external audit reports.

We did not perform an overall assessment of TMC's internal control structure. Rather, we reviewed only the internal controls that relate directly to our objective.

We performed our fieldwork at TMC's administrative office in Laredo, Texas.

METHODOLOGY

To accomplish our objective, we:

- met with ACF officials to discuss concerns;
- reviewed ACF's December 5, 2013, triennial report;
- reviewed TMC's October, 14, 2013, A-133 audit, the January 14, 2014, independent accountant's report, and the January 4, 2014, risk management fund audit;
- reviewed relevant Federal laws, regulations, and guidance;
- reviewed grant award documentation to determine the amount of Federal funding that TMC received;
- interviewed TMC's management to gain an understanding of TMC's internal control procedures related to accounting;
- reviewed compensation of the board of directors for compliance with corporate bylaws and Federal regulations;
- performed a trend analysis on payroll to test for unusual compensation trends and pay in excess of Federal compensation limits;
- recalculated TMC's indirect cost rate;
- reconciled health insurance costs from vendor invoices with the general ledger and payroll reports;

- reconciled the costs TMC claimed on its final Federal Financial Status Report with its general ledger;

- created cash flow statements for OHS programs and funds;

- selected and reviewed a nonstatistical sample of 92 transactions based on our review of a listing of ACF's concerns, a triennial report, and other external audit reports; and

- discussed the results of our review with TMC 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 B: TEACHING & MENTORING COMMUNITIES COMMENTS

TMC
TEACHING & MENTORING COMMUNITIES

December 1, 2015

Patricia Wheeler
Regional Inspector General for Audit Services
United States Department of Health and Human Services
Office of Inspector General
Office of Audit Services, Region VI
1100 Commerce Street, Room 632
Dallas, TX 75242

Re: Report No. A-06-14-00036 – Teaching and Mentoring Communities Unallowable Claimed Head Start Costs

Dear Ms. Wheeler:

Teaching and Mentoring Communities ("TMC") appreciates this opportunity to respond to the United States Department of Health and Human Services ("HHS"), Office of Inspector General ("OIG") draft audit Report No. A-06-14-00036 entitled Teaching and Mentoring Communities Unallowable Claimed Head Start Costs reviewing TMC's expenditure of federal Head Start funds during the period from February 1, 2012 through January 31, 2014.

The draft audit report focuses on three disallowances and a finding regarding the adequacy of TMC's financial systems and controls.

The first disallowance relates to the reasonableness of health insurance costs charged to TMC's federal award(s). The draft report indicates that the actual cost of employee health insurance premiums during the relevant time period was some $616,898 less than what TMC allocated to Head Start assistance and employee contributions, and that $616,898 in claimed Head Start costs is therefore unallowable.

The OIG draft report further finds that TMC failed adequately to document work performed under a consulting contract between TMC and a former employee. As a consequence, OIG has determined that $15,750 in payments to the vendor out of Head Start grant dollars is unallowable.

The third disallowance consists of OIG's observation that TMC charged $2,310 to Head Start funds for membership dues in "various chamber of commerce organizations" without first obtaining prior approval from HHS in violation of federal cost principles at 2 C.F.R. Part 230, Att. B, § 30(c). The draft report

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therefore recommends that HHS disallow the full amount of such membership dues paid with federal dollars.

Finally, the draft audit report contains a finding that TMC did not have at least one governing board member with financial or accounting expertise from September 2012 through August 2013 as required by law. The draft report observes that TMC's governing board approved a transfer of $275,000 from the organization's health insurance fund to make up a shortfall in its general fund. OIG thus suggests (1) that the inter-fund transfer was improper, and (2) that the Board of Directors might not have approved the shift of funds had TMC been in compliance with the relevant board composition requirements.

The following addresses each of these matters in turn:

1. Excessive Charges for Health Insurance – $616,898 Recommended Disallowance

TMC concurs with this finding with certain caveats. TMC understands that it is only entitled to use its federal awards to cover the actual cost of goods and services it consumes in the performance of its federally-supported activities. TMC likewise understands that any amounts charged to federal funds in excess of actual costs are unallowable. TMC will therefore cooperate with relevant program staff to quantify and resolve any disallowance associated with the health insurance overpayments identified in the draft audit report.

That said, TMC wishes to stress that it has taken what it believes to be appropriate steps to ensure against the recurrence of such improper charges to its federal awards. TMC has long-since ceased its previous practice of applying a multiplier of greater than 1 in calculating its health insurance costs. As of the end of the period audited by OIG, the amounts that TMC has paid for health insurance out of Head Start dollars have been no more than the total cost of insurance (less total employee contributions).

In addition, TMC has eliminated the separate account for health insurance in its book of accounts and is in the process of closing down all bank accounts except the general and payroll accounts. TMC believes that this will enhance transparency and minimize the potential for confusion over which funds are restricted and which are not.

2. Unsupported Contract Payments – $15,750 Recommended Disallowance

TMC also concurs with this finding. TMC will work with relevant program staff to identify any additional documentation that would support the contract payments at issue, and will cooperate with program officials in resolving any unallowable costs.

As to the recommendation that TMC "ensure that all consulting costs are supported by adequate supporting documentation," TMC has undertaken steps to make certain both that staff is aware of the need to document all contract deliverables and that staff in fact maintains such documentation. TMC has trained staff in the documentation requirements contained in the Office of Management and Budget Uniform Guidance. TMC has also increased its efforts to monitor staff compliance with those requirements.

3. Membership Dues Lacking Prior Approval – $2,310 Recommended Disallowance

TMC concurs with this finding. Accordingly, TMC will cooperate with relevant program staff to quantify and resolve any disallowance associated these expenditures.

TMC has also implemented measures to safeguard against the use of federal funds without prior approval where such approval is required under the cost principles. Those measures include, among other things, staff training in the prior approval provisions in the Uniform Guidance and oversight over compliance with such prior approval requirements.

4. Lack of Board of Directors Oversight

The draft audit report cites (1) the absence of a governing board representative with financial and/or accounting expertise for a period of approximately eleven months, and (2) the approval of a $275,000 transfer of money from the health insurance fund to the general fund during that time frame as grounds for the conclusion that the TMC Board of Directors failed to fulfill its supervisory functions. The draft report therefore recommends that TMC "ensure that a fiscal management or accounting representative who is knowledgeable of Federal Head Start requirements is on the board of directors."

TMC has already addressed the non-compliant condition identified by OIG. As the draft report acknowledges, the TMC governing board was without a financial/accounting representative from September 14, 2012 to August 8, 2013. TMC's Board of Directors has included at least one member (currently two) with a finance/accounting background at all times subsequent to August 8, 2013.

TMC's Board of Directors has enhanced its supervisory role in other ways. For instance, the governing board's finance committee is now a committee of the whole, i.e., staff reports to the entire Board of Directors (as opposed to a subsection thereof) regarding TMC fiscal matters. In addition, the Chief Financial Officer is now a direct report both to the Chief Executive Officer and the Board of Directors. The board also recently created a Quality Assurance Committee comprised of board representatives and staff, including individuals from TMC's Compliance Department. TMC believes that these mechanisms maximize the flow of pertinent financial information from staff to the governing board.

Finally, TMC hastens to observe here that there are at least two further factors that mitigate any perceived lack of diligence on the part of the Board of Directors in connection with the $275,000 transfer from the health insurance fund to the general fund.

First, as the draft audit report reflects, former finance staff presented the governing board with two options for addressing a significant budget shortfall at one TMC site. Staff characterized one option – recording a loss in the general fund – as problematic because it would "raise questions for all of our programs." The other option of covering the shortfall with funds from a "nonrestricted account" was offered as a permissible alternative. Relying on the advice of finance staff that the health insurance fund contained "nonrestricted" funds, the Board of

Directors authorized the transfer. Had the board been aware that the health insurance fund monies were not, in fact, "nonrestricted," it is at best questionable whether it would have allowed the transfer.

Second, shortly after the decision to tap the health insurance fund to cover the general fund deficit, the Board of Directors became sufficiently concerned about the advice it was receiving from senior management to engage the services of an independent forensic accounting firm (separate from TMC's independent auditors) to look into allegations of improper actions taken by executive staff. It was the report of the independent forensic auditors that identified the transfers of money from the health insurance fund to the general fund as questionable, which in turn precipitated the OIG review that is the subject of the draft audit report. In other words, it was the governing board's exercise of its oversight powers that uncovered some or all of the improprieties found by OIG.

* * *

TMC again thanks OIG for this opportunity to provide input regarding the draft audit report. As set forth above, TMC believes that it has made substantial strides to implementing systems to safeguard against the irregularities identified in the draft report and otherwise to ensure compliance with the law and the terms and conditions of TMC's federal awards. TMC looks forward to working with relevant program officials toward resolving the issues OIG has raised, and thereby to allow HHS to rest assured that TMC is a responsible steward of public funds.

Sincerely,

Cesar Sotelo
Chief Executive Officer