DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

# Memorandum

Date: JAN 27 1992

From: Richard P. Kusserow
Inspector General

Subject: Report on Summarization of Head Start Grantee Audit Findings (A-07-91-00425)

To: Jo Anne B. Barnhart
Assistant Secretary for
Children and Families

The attached management advisory report on the Head Start program is provided for the purpose of alerting you and your staff to the issues and concerns that have been identified by audits at Head Start grantees. Training and technical assistance as well as fiscal and program oversight would be helpful to correct persistent deficiencies in grantee internal controls and reporting systems.

The report includes a summary of over 4,000 Head Start program audit findings identified in some 1,200 audit reports issued between October 1, 1987, and August 30, 1990. The audit reports issued by the Office of Inspector General were performed by certified public accountants and other nonfederal auditors to satisfy the mandated Head Start program audit requirements. Findings and recommendations in these reports were previously submitted to the Office of Human Development Services for resolution under the Departments' audit resolution process. In some instances, we noted recurring problems were reported over several years by the nonfederal auditors. This indicates a need to reevaluate the audit resolution procedures of the Administration for Children and Families (ACF).

The major management control problems related to accountability over grant funds. Accountability findings encompassed the adequacy of the internal control systems, recordkeeping systems and procedures, financial and program reporting and cash management controls. We identified concerns with accountability over program funds at 530 grantees. This represents about 71 percent of the grantees that were audited and 51 percent of the total findings identified. Strengthening internal controls at the grantee level provides opportunities for better use of program funds as well as enhancement to the fiscal integrity of the grantee program system.

The reports disclosed the following types of specific problems:

- o Head Start funds were not being placed in interest bearing accounts as required by Federal regulations;
- o Head Start funds were loaned to other grantee programs:
- o financial reports contained inaccurate/incomplete information;
- o matching requirements were not met: and
- o weaknesses existed in student eligibility or enrollment procedures.

The summarization of audit findings along with our supplemental analyses reemphasizes the need for the ACF to continue strengthening its monitoring and oversight efforts over its some 1,300 grantees charged with the responsibility for administering the Head Start program.

We are recommending that ACF reevaluate all important aspects of financial management and accountability including technical assistance, financial reporting, tracking audit reports and audit resolution. In addition, due to the anticipated expansion in the number of grantees, for all new grantees ACF should consider prior to the issuance of the grant award performing a financial management capability review. This review is designed to assess the strengths and weaknesses of the financial management systems established to control Federal funds and to detect and correct deficiencies during the early stages of the grant award process. We are not making any further recommendations relating to monitoring and oversight since action is already underway through the Federal Managers' Financial Integrity Act process to improve monitoring and oversight activities.

We believe that this document will provide some insights and will be helpful as ACF implements its Head Start expansion program.

Comments to our draft report indicate that the ACF is in general agreement with the recommendations contained in the report. The comments also indicate that the ACF has initiated the implementation of most of these recommendations. A copy of these comments have been incorporated to the report as Appendix I.

If you have any questions, please call me or have your staff contact John A. Ferris, Assistant Inspector General for Human, Family and Departmental Services Audits, at (202) 619-1175.

Attachment

Department of Health and Human Services

# OFFICE OF INSPECTOR GENERAL

# MANAGEMENT ADVISORY REPORT--SUMMARIZATION OF HEAD START GRANTEE AUDIT FINDINGS

Richard P. Kusserow
INSPECTOR GENERAL

CIN: A-07-91-00425

## SUMMARY

This management advisory report presents the results of our study and analysis of Head Start grantee findings identified in 1,262 audits performed by certified public accountants and other nonfederal auditors generally to satisfy Federal program audit requirements. The objectives of our review were to categorize and summarize instances of noncompliance and internal control weakness contained in reports and identify target areas of potential risk for the program.

The report summarizes problem areas relating to accounting and management control systems at the program grantee level that require fiscal and program oversight efforts to ensure that the Head Start grantees have adequate management systems and controls in place to protect the integrity and stewardship of Federal program funds. Appendix A contains an identification of the types of findings reported by the nonfederal auditors and the total number of findings reported for each category.

The problems identified can be categorized into the following three generalized areas of concern.

ACCOUNTABILITY - These findings encompassed the structure of the internal control systems, record keeping systems and procedures, and financial reporting. Accountability problems relate to such matters as policies and procedures being incomplete and/or not being followed; accounting records not containing up-to-date information: travel expenses were not documented: and financial reports were submitted untimely and information contained in the submitted financial reports to Federal officials was inaccurate.

GRANT MANAGEMENT - These findings relate to compliance with Federal rules and regulations--inadequate files to support the eligibility of children to participate in the program, daily attendance requirements were not met, grantee did not meet the mandatory matching requirements and centers were not in full compliance with the State's licensing requirements.

CASH MANAGEMENT - Problems related to the adequacy of the systems used to safeguard cash. The following types of problems were noted: program funds not being kept in interest bearing accounts as required, interest earned on grant funds not being returned to the Federal Government on a timely

basis, Head Start funds were loaned to other programs and to the unrestricted accounts through interfund transfers, grant funds were deposited in unsecured bank accounts with balances that exceeded Federal Deposit Insurance Corporation (FDIC) limits, drawdowns from the Department's Payment Management System (PMS) were untimely or the cash on hand exceeded the cash needed and unobligated fund balances were not reprogrammed or returned on a timely basis.

Officials should already be aware of the issues in this report, because the issues have been included in individual nonfederal audit reports on the grantees and the reports have been through Administration for Children and Families (ACF) audit resolution process. However, this report presents a programwide picture of grantee problems which require ACF reevaluation of all important aspects of management and accountability including technical assistance, financial reporting, tracking audit reports and audit resolution.

The processes or action steps that can be taken by ACF to improve the fiscal accountability of Head Start grantee funds are as follows:

--increase training and technical assistance to grantees;

--continue strengthening its monitoring procedures to improve grantee accountability;

--implement the new audit requirement for nonprofit organizations administering Federal programs mandated by Office of Management and Budget (OMB) Circular A-133;

--strengthen procedures to ensure all grantees use interest bearing accounts and properly refund interest income;

--develop procedures to detect grantees with interfund transfers;

--reevaluate procedures to ensure excess cash is not drawn and obtain evidence that legitimate balances in excess of the FDIC limit are collaterally secured when awarding grants;

--reemphasize to grantees' that the nonfederal match is to be properly documented and met;

- --require evidence during the grant application process of current licensing or compliance with all of the facility standards; and

- --emphasize the possibility of savings to the Head Start program through use of sales tax exemptions and timely deposits of tax refunds.

In the comments to our draft report, the ACF generally agreed with our recommendations. A summary of ACF's comments and the related Office of Inspector General (OIG) response is included after each recommendation. The full text of ACF's comments have been incorporated to this report as Appendix I.

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# INTRODUCTION

## BACKGROUND

Head Start is a national program providing comprehensive child development services. The overall goal of Head Start is to bring about a greater degree of social competence in children who may be economically disadvantaged or have special education or service needs. Social competence is defined as a child's everyday effectiveness in dealing with their environment and later responsibilities in school and life.

Head Start is administered by the Commissioner, Administration for Children, Youth and Families within the Administration for Children and Families (ACF). Head Start is the largest federally funded child development program, and it is 1 of the few large programs in the Department funded directly to local grantees through the 10 regional offices. Congressional appropriations for the 3 Fiscal Years 1988, 1989 and 1990 represented in the review were approximately $3.83 billion with 1,387,904 children served during that time frame.

Grantees include local governments, school boards, community action agencies and single purpose nonprofit organizations. Grantees are required to contribute or match at least 20 percent of the cost of the program each grant year. Grantees submit grant applications which are reviewed and approved by the ACF regional and/or headquarter office. Except for headquarters administered grants, the regions are responsible for monitoring grantees and resolving audit findings identified in nonfederal audits.

To ensure the safety and well being of the children as well as promote the educational process, Head Start facilities must meet facility standards and/or obtain local licenses. Compliance with standards is a condition of funding.

## SCOPE

To review Head Start findings in nonfederal audit reports, we started with the Audit Inspections Management System (AIMS), an OIG management information data base, for the period October 1, 1987 through August 30, 1990. A total of 2,776 of the 10,125 nonfederal audit reports in AIMS indicated that Head Start funding was included and 1,262 reports from 719 grantees were identified as containing Head Start findings. Findings related to these reports were as follows:

| | Number of Reports | Number of Findings |
|---|---|---|
| Nonfederal Audit Reports in AIMS | 10,125 | 20,929 |
| Reports With Head Start Funding | 2,776 | 5,616 |
| Reports With Head Start Findings | 1,262 | 4,027 |

We obtained a brief description of the finding, the amount of Head Start expenditures, and total expenditures for the 4,027 Head Start findings from the regional OIG offices. The identifying information from all regions was analyzed and findings were assigned codes designating specific problems and type of grantee. The 1,262 reports contained Head Start expenditures of $1.4 billion. The majority of the Head Start grantees submitting these 1,262 reports with findings were either Community Action Agencies (27 percent) or other nonprofit organizations (56 percent).

This report is based on our analysis of findings in the AIMS data base, with two exceptions. First, we selected 30 organization-wide nonprofit audit reports which had not yet been processed through AIMS to determine whether the financial statements were consistent in their presentation of the grantees' financial conditions. These 30 audit reports were selected because they were easily identified as organization-wide audits, as having direct Head Start funding, and as having total Head Start expenditures of $500,000 or more. Second, we used two nonprofit audit reports which were not in AIMS to illustrate problems with interfund transfers. These two reports were easily identified because they were currently being processed by us.

Our report includes nine appendices. Appendix A contains a detailed listing of findings that were identified in the nonfederal audit reports. Appendices B and E contain Head Start statistics broken out by Federal region and by type of grantee, respectively. Appendices C and F contain our review findings broken out by Federal region and by type of grantee, respectively. Appendices D and G contain details on the accountability problems broken out by Federal region and by type of grantee, respectively, and Appendix H contains a comparison of the timeliness of audit information between the Head Start program annual requirement and the new OMB mandated audit requirements for nonprofit organizations. Appendix I incorporates ACF's comments to a draft of this report.

Our analysis was performed in Kansas City, Missouri and Washington, District of Columbia during the period October 15, 1990 to June 15, 1991.

## FINDINGS AND RECOMMENDATIONS

### ACCOUNTABILITY

Accounting is defined as the process of recording transactions and events affecting the grantee and communicating this information to external decision makers.

Issues related to accounting and the system of accountability comprised 51 percent of the total instances of noncompliance reported by the auditors. At first, we believed that the noncompliance resulted because grantees were small and lacked sufficiently trained staff to properly account for the funds. However, we found that 62 percent of the reports with accounting problems related to grantees with over $1 million in total expenditures.

Most accounting texts identify reliability, comparability, and relevance as the characteristics that make information useful for decision making. We used these characteristics to evaluate accountability.

> Reliability is the quality that assures information is reasonably free from error and bias and is correctly represented. Maintaining accurate, timely records is the foundation of financial accounting and the basis for reliability. To be reliable, information must be verifiable.
>
> We believe Head Start financial information is not always verifiable because of the lack of sound accounting standards and practices in grantee accounting systems. Accounting procedures were identified as inadequate or not implemented in 314 instances, including 45 for lack of segregation of duties. There were 632 instances that related to inaccurate general ledgers, accounting records, bank statement reconciliations, monthly financial statements, grantee records, and other record-keeping errors.
>
> Inadequate documentation, inaccurate records, and lack of segregation of duties were also problem areas for cash controls. These deficiencies resulted in 352 instances of problems such as unauthorized disbursements, untimely recording of

deposits and checks, and cash receipts and disbursements not segregated or not recorded properly.

Inadequate recordkeeping also affected fixed asset management and travel with 223 weaknesses concerning inventories not taken or inaccurate fixed asset record management and 74 instances related to travel documentation.

We believe these weaknesses indicate that grantees are not managing the accounting process in an accurate and timely manner. Therefore, financial information is not totally reliable for use by Head Start program decision makers.

Comparability is the quality of accounting information that enables users to identify similarities in and differences between two sets of data. Because of their detachment from the grantee, external users cannot directly obtain specific information from the grantee, and therefore, must rely on the financial statements. We determined that the financial information displayed in nonfederal audit reports of nonprofit organizations was not consistent or comparable for Federal financial management, because Generally Accepted Accounting Principles (GAAP) for nonprofits were not well defined. (This issue is discussed later in the report. See Nonprofit Financial Statements.)

Relevance relates specific items of information to a particular grantee and is a function of predictability, timeliness and feedback.

--To be relevant to a decision concerning funding for a grantee, accounting information should predict cash flows and measure the risk associated with grantee activities.

The application process for Head Start funding requires the submission of a budget for the fiscal period to be funded. A grant award constitutes prior approval for the expenditure of funds for specific items included in that budget. Grantees may make revisions between and among most budget categories to meet unanticipated requirements, provided that grant funds will be used for purposes consistent with Federal regulations or policies governing the program. Grant budget revisions exceeding Federal flexibility guidelines and requiring prior approval from Head Start program officials are explicit.

--Timeliness is essential for information to be relevant because information obtained too late cannot be useful to a decision maker.

Head Start grantees are required to submit Financial Status Reports (FSR) to report grant awards and program expenditures. These reports are submitted quarterly or semiannually, due 30 days after the end of the first period and yearly 90 days after the end of the budget period. The FSR identifies program outlays and income on the same accounting basis used in the grantee accounting system. Information reported must be reconcilable to the grantee books. Up to 90 days of Federal funding for a new grant period will have transpired before a review of the prior year performance can be made.

--To be relevant to the decision maker, users must be able to obtain feedback from the information to confirm or correct prior expectations.

Head Start grantees receive cash drawdowns from PMS. After grant awards are approved, the amounts are recorded in the PMS system. The PMS requires the recipient to submit the Federal Cash Transaction Report 15 days after the end of the quarter to report Federal cash disbursements and the cash balance. The PMS does not have any information to verify amounts submitted on the report. Through the use of computer controls, total drawdowns are limited to total awards.

With the exception of on-site visits, program officials do not receive information on the accuracy of the Cash Transaction Report and the FSR until the audit report is submitted. Only during the independent audit is it determined whether these reports were correctly prepared from the accounting system. Generally, the audit report is the only means available to the program officials to reconcile grant drawdowns, grant awards and expenditures.

In 85 instances, the auditors reported inadequate budget controls or unapproved budget revisions. In 109 instances, required reports were not timely. In 273 instances, the required reports were inaccurate.

We believe that problems with accountability, particularly timeliness, will increase in future years. For nonprofit audits of fiscal years that begin on or after January 1, 1990, OMB Circular A-133 will allow audits to be performed every 2 years rather than annually. The grantee is allowed 13 months after the end of the 2-year period to complete and submit the audit. Therefore, information on the first year's expenditures will be over 2 years old and for the second year will be 13 months old before the granting agency is informed about the accuracy of the FSR. Program officials will be awarding new funding before an evaluation can be made of prior financial performance. See Appendix H for the time lapse comparison for nonfederal audits between the prior annual program audit and the new OMB audit requirement. Alternative methods and approaches will need to be developed by ACF to ensure timely closeout of grants using the nonfederal audit reports as a check on the accuracy of the closeout process as opposed to total reliance on audit reports for closeout.

Recommendation

We recommend that the ACF:

--continue strengthening its monitoring procedures to improve grantee accountability;

--develop alternative procedures for timely closeout of grants, placing less reliance on the nonfederal audit reports; and

--focus the technical training workshops towards developing model systems, techniques and methods to improve grantee accountability.

ACF Comments

The ACF stated in their written response that they shared our concerns that the provisions of OMB Circular A-133 will not permit the program to assure timely closeout of grants. However, they believe that appropriate nonfederal audit procedures are the correct method for timely closeout of grants. The comments indicated that for Head Start, the financial audit is an essential informational tool for managers in making decisions, such as grant closeout. Finally, ACF indicated that they will continue to explore alternatives which will provide them with the information to provide necessary oversight of Head Start grantee financial management.

OIG Response

The ACF comments did not address their current practice of grant closeout using the grantees final FSR in lieu of receiving the audit report. This practice has been followed since the Head Start program audit guide was phased out in the early 1980's and the requirements for State and local governments of an annual program audit where changed in 1984 (OMB Circular A-128). In addition, the ACF is currently refunding grantees under the skip year concept (Final FSR for Fiscal Year 1 will be used to adjust funding for Fiscal Year 3), with or without the audit report for the corresponding Fiscal Year. Therefore, we believe that ACF should develop alternative procedures for the timely closeout of grants using the nonfederal audit reports as a check on the accuracy of the process.

NONPROFIT FINANCIAL STATEMENTS

As a part of this review, we made a comparison of the financial statements of 30 organization-wide nonprofit audits covering Head Start funds. This comparison was performed to determine if there were any trends that could be used to evaluate financial performance and predict potential problems. However, we were unable to identify trends because numerous bases of accounting and reporting formats were being used.

While the financial statements in the audit reports were presented in accordance with GAAP, this presentation did not signify comparability. Currently, GAAP allows alternative treatments for like items. Statements can be prepared on a full accrual, modified accrual, or modified cash basis and still comply with GAAP.

In our review we identified 28 grantees which did not present a Statement on Changes in Financial Position. The Statement of Changes in Financial Position provides information with regard to investing and financing activities, financial risk and future financial resource flows. More specifically, the statement aids users in answering financial questions such as:

--Does the decreasing trend in internal financing indicate serious future problems?

--Does the source of financing indicate that the risk due to the use of debt is too high?

We noted that the guide for Voluntary Health and Welfare Organizations prepared by the American Institute of Certified Public Accountants (AICPA) does not require the presentation of a Statement of Changes in Financial Position. Further, research indicated that four audit and accounting guides prepared by the AICPA for nonprofit grantees describe a total of seven different financial statements, of which, only three or four are required, depending on the grantee.

The fundamental purpose of accounting is to communicate financial information to assist in the evaluation of prior performance, display current financial position and aid in the planning of future actions. Although a certain degree of flexibility in format and financial statement classifications is generally considered desirable to allow the presentation of special situations, we believe there must be a reasonable degree of uniformity. The use of inconsistent and unique classifications can conceal waste and inefficiency and prevent Federal resources from being allocated in a reasonable manner. Our review of the 30 audit reports indicated that the financial statements did not clearly present the grantees' assets and liabilities.

For example, in a report not included in the 30 mentioned previously, assets of 1 grantee were seized by the Internal Revenue Service for failure to pay withholding tax. Apparently, Head Start program officials were unaware of these debts because the debts never appeared on the financial statements. Without the use of accruals, there was no clear indication of debt structure, and it was not possible to assess the ability of the grantee to meet future obligations or judge the ability of the grantee to continue as a going concern.

According to Government Auditing Standards, the Financial Accounting Standards Board (FASB) will establish accounting principles for nongovernment grantees. Since the inception of the FASB in 1973, the majority of the standards set have pertained to profit oriented businesses. A set of GAAP for nonprofit organizations has not been established by the FASB. Instead, various industry groups have developed uniform accounting principles applicable to their type of nonprofit organizations. Also, the AICPA has issued audit guides covering certain types of organizations, and a Statement of Position covering all other nonprofit organizations not covered by the audit guides. Accordingly, financial information has been presented under different bases of accounting and in various formats all of which are currently considered "Generally Accepted." Generally accepted auditing standards allow the auditor to rely upon industry practice in determining generally accepted accounting practice.

In December 1988 the AICPA issued a report to the FASB on financial presentation that proposed recommendations for possible solutions to the format and classification variances of nonprofit organizations. Since that time, the FASB has not taken any decisive action and has postponed deliberations on the issue. According to the latest schedule, a draft exposure statement is not expected to be issued until the fourth quarter of 1991 and public hearings cannot be considered until sometime in 1992. The FASB has not scheduled a date for adoption of a final statement. However, based on normal practices, a.final statement cannot be expected before 1993.

Issuance of OMB Circular A-133 will intensify the need for a consistent definition of nonprofit GAAP for fiscal years that begin on or after January 1, 1990. For OMB Circular A-128, OMB mandated a specific set of financial statements for State and local governments which the AICPA and others helped develop. The same action is expected for OMB Circular A-133.

Recommendation

We recommend that the ACF:

--closely observe the progress being made by the AICPA and the OMB in formulating required financial statements for nonprofit organizations providing guidance to its grantees when literature is available.

--implement the new audit requirement, OMB Circular A-133, as this will improve the consistency of audited financial statements.

ACF Comments

The ACF concurred with our recommendation that they closely observe the progress being made by the AICPA and the OMB in formulating required financial statements for nonprofit organizations and providing guidance to its grantees when literature is available. The ACF stated that they recognize the value of a consistent definition of GAAP for nonprofit organizations and that their grants office will be asked to monitor this important activity and keep programs abreast of progress. However, in their comments, the ACF did not fully agree as to the future usefulness of nonfederal audits of nonprofit organizations as mandated by OMB Circular A-133. The ACF is very concerned that the new provision of A-133, which does not require an audit to be completed until 13 months after the end of the 2-year budget period, will considerably reduce the value of the audit as a management tool. In addition, ACF stated that prior to OMB Circular A-133, Head Start audits were due annually, no later than 120 days from the end of the budget period, allowing adequate time to review the audit and to discuss with the grantee any compliance issues prior to refunding. Finally, the ACF would also like to look into the possibility of using the flexibility provided in the Circular to require annual program rather than institutional audits of Head Start grantees, where appropriate.

OIG Response

We do not agree with the ACF statement that the implementation of OMB Circular A-133 could reduce the value of audits as a management tool. The ACF response did not clearly address the current lack of consistency among nonprofit financial statements. As previously stated in the report, this lack of consistency precludes comparisons to determine if any trends exist that could be used to evaluate financial performance and predict potential problems. We believe that implementing the provisions of the Circular will provide ACF with a better, more comparable management tool than previous nonprofit financial statements. In addition, the ACF must understand that implementation of OMB Circular A-133 is mandatory and not optional.

INTEREST BEARING ACCOUNTS

Federal regulations require nonprofit organizations to maintain Federal funds in interest bearing accounts and remit earnings in excess of $100 annually to the Federal Government on a quarterly basis. In 124 instances, auditors reported that grant funds had not been deposited in interest bearing accounts or the grantee had not remitted interest earned. For eight grantees, failure to deposit program funds in interest bearing accounts or to remit interest earned on Federal funds was a recurring problem, continuing for 2 or more years.

Federal income is reduced when grantees earn interest on advances, but do not remit the proceeds to the Federal

Government. Federal regulations dictate the method of repaying interest earned on advances of grant funds. When grantees do not deposit program funds in interest bearing accounts or remit interest earned, potential Federal income is lost.

Because the issue represents potential monetary loss to the Federal Government, we believe that monitoring procedures related to interest income should be strengthened.

Recommendation

We recommend that the ACF:

--strengthen procedures to ensure all grantees use interest bearing accounts and properly earn and refund interest income.

ACF Comments

The ACF concurred with our recommendation.

INTERFUND TRANSFERS

Requesting funds which are not necessary for the Head Start program and transferring these funds to other programs is contrary to Federal regulations. The regulations specifically state that grantees may not request advances in excess of the Federal share of projected outlays. Further, grant funds may only be used for allowable costs of activities for which the grant was awarded and may not be transferred to other programs. In 109 instances funds were transferred between programs in nonprofit grantees to cover cash flow needs. Approximately $967,000 in Head Start funds had been loaned to other programs.

Analysis showed that 16 grantees had recurring interfund transfers. For example, one grantee loaned monies between programs to meet short-term cash needs for 2 years and had interfund receivables/payables outstanding at the end of the grant year, while another grantee transferred monies to pay the expenditures of other programs for 3 consecutive years.

Transferring or loaning these funds to other programs may also result in Head Start deficits. Further, we believe unauthorized lending and borrowing of grant funds can result in increased interest cost to the Federal Government and the risk of loss due to misappropriation.

Two audit reports not yet entered into AIMS at the time of our review further illustrate the interfund transfer problem. One grantee transferred a deficit of $176,681 from the unrestricted fund balance to the Head Start fund with the approval of regional Head Start officials. The deficit was caused by an over expenditure in the prior year when Head Start funds were transferred to cover expenditures applicable to an expected Social Services grant that was never approved. Another grantee transferred Head Start funds to other programs and to another corporation. The grantee used Head Start funds for purposes not related to the program and had no Head Start expenditures for the last 2 years.

Recommendation

We recommend that the ACF:

--develop procedures to detect grantees with interfund transfers. The starting point may be a detailed analyses of the financial statements.

ACF Comments

The ACF concurred with our recommendation.

FDIC LIMITS

Federal regulations require that grantees make provisions to ensure amounts in excess of the FDIC limit are collaterally secured. Uncollateralized deposits in excess of FDIC limits could be lost if banks become insolvent. According to the Wall Street Journal, January 17, 1991, 31 nonprofits recently lost money due to the failure of a New York bank. Further, a large loss could also result in inability to operate the program or insolvency of the grantee.

We identified 20 instances where the bank account balances in excess of the $100,000 FDIC limit were not collaterally secured. Two of the grantees had recurring findings.

Large cash balances could result from poor cash management. There were 106 instances where drawdowns were untimely or exceeded the cash needed to operate the program. Further, in 13 of the 20 instances where balances exceeded the FDIC limit, total annual expenses of the Head Start program were less than $1.2 million and equal monthly drawdowns would not have exceeded $100,000. However, balances at these grantees still exceeded the

$100,000 insurance limit. Therefore, an excessive cash balance was being maintained.

With a personal computer and a modem, grantees can request funds as frequently as daily from the PMS. Funds requested via computer or by mail are electronically transferred to a local bank. Therefore, most grantees should be able to prevent balances in excess of the limit.

Grantees with large grants could legitimately have individual drawdowns that exceed the FDIC limit due to the size of the program. If large balances are unavoidable, the excessive balance over the FDIC limit should be collateralized to eliminate the risk of loss.

Due to the increasing frequency of bank failures, strict adherence to cash management regulations should be required.

Recommendation

We recommend that the ACF:

--strengthen procedures to ensure excess cash is not drawn and obtain evidence that legitimate balances in excess of the FDIC limit are collaterally secured when awarding grants.

ACF Comments

The ACF did not concur with our recommendation to obtain evidence that legitimate balances in excess of the FDIC limit are collaterally secured when awarding grants. In their written comments, the ACF stated that this finding and recommendation in the report illustrates OIG's misrepresentation of the rules on FDIC limits, and added that "current rules require Federal fiscal officers to insure that legitimate balances in excess of FDIC limits are collaterally secured, however, we know of no such requirement for grantees in either law or Federal regulations."

OIG Response

The ACF stated in its response that they do not know of any current requirements to insure legitimate balances in excess of FDIC limits other than those for Federal fiscal officers. The aforementioned requirement is contained in attachment A of OMB Circular A-110 (Grants and Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations) and applies, by definition, to all Head Start grantees that are nonprofit organizations. There is no possible misrepresentation of this fact. Therefore, we do not agree with the ACF statement and believe that this requirement must be fulfilled.

MATCHING REQUIREMENTS

Each grantee is required to contribute 20 percent of the total cost of the Head Start program. This contribution may be in cash, in-kind services and equipment, or allowable costs borne by nonfederal grants. When this matching requirement is not met, the grantee must obtain approval from Head Start program officials for a smaller match or return grant funds not matched. When a Head Start grantee must return Federal funds because the match is not met, the ability of the grantee to provide services may be restricted and ultimately the children may not receive a level of service that was expected when the grant funds were awarded.

In 233 instances, grantees did not comply with various aspects of the Federal regulations regarding the matching requirements. In 81 of these cases, the required 20 percent match was not met. About $6.8 million in Federal funds were identified as not having the required matching contribution.

Inadequate or inaccurate documentation of matching was identified in 100 instances. In 52 other cases, improper valuation of in-kind contributions was a problem. Federal regulations dictate the method of valuation for many types of property and services. Records must show how the value placed on in-kind contributions was calculated.

Recommendation

We recommend that the ACF:

--reemphasize to grantees that the nonfederal match is to be properly documented and met.

ACF Comments

The ACF concurred with our recommendation.

GRANT MANAGEMENT

There were 1,000 instances of weaknesses and noncompliance that we categorized as grant management problems. These instances related to eligibility, attendance, salaries and fringe benefits, fund balances, expenditures in excess of budget, indirect costs, bidding regulations, prior approval and other cost issues.

--In 254 cases, eligibility or enrollment requirements were not met, including 145 related to inaccurate or inadequate documentation and 109 related to inadequate procedures for enrollment. Family income must be verified by the grantee before a child is determined eligible to participate in the program. Verification of income must be documented in the file.

--In 78 cases, attendance expectations were not met or were inadequate. According to the program goals, Head Start grantees are expected to maintain a minimum average daily attendance rate of 85 percent of their funded level of enrollment. Grantees are expected to analyze the causes of absenteeism and develop strategies to improve their attendance rate if it dips below 85 percent. Follow-up support services are expected to be provided to families when a child has 3 or more days of unexcused absence.

--In 102 cases, salaries and fringe benefits were unallowable, or incorrect or related procedures were deficient. Of the 102 cases, 9 related to unallowable employee bonuses, 46 related to unallowable employee fringe benefits and 47 encompassed diverse salary issues such as inaccurate payroll tax calculation, no segregation of payroll duties, and inadequate payroll documentation.

--In 78 cases, unobligated fund balances were a problem. Generally, the problem occurred because unobligated balances were not returned or reprogrammed in a timely manner as required. In nine cases, the unobligated balance related to a grantee whose funding was discontinued.

--In 73 cases, grantee expenditures exceeded the grant award. We believe these instances may have resulted from poor management of the budget.

--In 48 cases, indirect cost rates were not approved, developed, or correctly utilized.

--In 39 cases, bidding regulations for purchases were not followed.

- --In 38 cases, prior approval requirements for property were not met. Prior approval from Head Start program officials is required for equipment purchases and for transfer of property.

- --In 290 cases, other cost issues were identified. Included were 247 unauthorized program expenditures, 6 related party transactions and 37 cases where costs were allocated to improper grant periods.

We believe these issues demonstrate a need for better monitoring of grant management.

Recommendation

We recommend that the ACF:

- --place emphasis during the technical training workshops on the types of reoccurring program compliance issues being reported by the nonfederal auditors.

ACF Comments

The ACF concurred with our recommendation.

FACILITIES

To be eligible to participate in the program, facilities must comply with Head Start standards. Standards applicable to the facilities require that centers meet 13 fire, health and safety requirements. Meeting State or local licensing requirements serves as evidence that a center is in compliance with all requirements.

In 58 cases, audits identified violations of Head Start facility regulations or safety standards. Facility safety standards were not met in 43 instances at 30 grantees. These cases may affect the safety and well-being of the children. At nine of the grantees, recurring violations were reported.

Of the deficiencies identified, 10 resulted from expired or nonexistent licenses and 33 were violations of fire, health and safety performance standards. These deficiencies included an unsafe and ineffective heating system, hazardous paint on-site, and lack of a working fire extinguisher, emergency lighting, or playground fencing.

Compliance with facility standards is a condition of Federal funding. However, we found that grantees not in compliance with standards continued to receive grant funds. Noncompliance with facility standards increases the risk that the safety and well-being of children may be jeopardized.

Because of the possible seriousness of the issue, we believe that, as a condition of continued funding, grantees should provide evidence of licensing or compliance with all of the facility standards.

Recommendation

We recommend that the ACF:

--require evidence during the grant application process of current licensing or compliance with all of the facility standards.

ACF Comments

The ACF concurred with our recommendation.

SALES TAX

We identified six cases of noncompliance where grantees did not use sales tax exemptions or did not return sales tax refunds. Sales tax exemptions can reduce costs of the program. Failure to take advantage of these exemptions would result in an unallowable cost under Federal cost principles.

Five of the six noncompliance cases related to grantees in the Atlanta, Georgia regional office. Discussions with Head Start program officials in Atlanta indicated that information on sales tax exemptions was emphasized and included in training sessions for both grantees and auditors. Since the issue was not reported in most other regions, it is possible that other regions do not have a problem with sales tax noncompliance. It is also possible that grantees and auditors are not aware of the potential savings.

We contacted 21 States with sales tax and determined that 76 percent allowed some form of exemption for nonprofits and governments. Although our information in this area is rather limited, there may be a potential for savings to the program.

Recommendation:

We recommend that the ACF:

--emphasize the possibility of savings to the Head Start program through use of sales tax exemptions and timely deposits of tax refunds.

ACF Comments

The ACF concurred with our recommendation.

# *APPENDICES*

# Findings Identified in Nonfederal Audit Reports

# FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

## ACCOUNTABILITY

| Number of Findings | |
|---|---|
| | --PROCEDURES |
| 269 | Accounting policies and procedures were inadequate or not implemented, the basis of accounting was inadequate or grantee policy and procedure manuals were not developed. |
| 45 | There was no segregation of the accounting duties. |
| 314 | Sub-total |
| | --RECORDS |
| 98 | General ledgers were inaccurate, entries were not posted, or a general ledger was not used. |
| 111 | Accounting records were inaccurate or inadequate. |
| 57 | The bank statement was not reconciled or not reconciled monthly. |
| 18 | Monthly financial statements were inaccurate, untimely, or not prepared. |
| 55 | Grantee records were inaccurate or inadequate or board minutes were not recorded. |
| 22 | Other accounting related findings that did not appear frequently and did not fall under the other categories. |
| 41 | Cash control findings that did not appear frequently and did not fall under another category. |
| 45 | Program expenditures were inadequately documented. |
| 49 | Records and reporting findings that did not appear frequently and did not fall under any other category. |
| 136 | Inadequate employee records or employee files. |
| 632 | Sub-total |

FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

| Number of Findings | |
|---|---|
| | --CASH MANAGEMENT |
| 102 | Inadequate documentation of cash receipts, disbursements, purchase orders, or vouchers. |
| 85 | Inaccurate cash receipt or disbursement records. |
| 41 | Disbursements were not properly authorized by grantee officials. |
| 66 | There was no segregation of cash receipt and disbursement duties. |
| 58 | Checks did not have two signatures, the checking account was overdrawn, or other checking account related problems. |
| 352 | Sub-total |
| | --FIXED ASSETS |
| 86 | Physical inventories of fixed assets were inadequate or untimely. |
| 104 | Asset records or inventory listings were inaccurate. |
| 3 3 | Fixed asset findings which did not appear frequently and did not fall under another category. |
| 223 | Sub-total |
| | --TRAVEL |
| 74 | Documentation of travel expenses or approvals were inadequate or inaccurate and repayments of travel advances were untimely. |
| 74 | Sub-total |
| | --PREDICTABILITY |
| 85 | Budget controls were inaccurate and the budget or specific line items were overspent. |
| 85 | Sub-total |
| | --TIMELINESS |
| 109 | Federal financial reports were late. |
| 109 | Sub-total |

## FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

| Number of Findings | |
|---|---|
| | --FEEDBACK |
| 273 | Federal financial reports were inaccurate. |
| 2,062 | Total - Accountability |
| | **INTEREST BEARING ACCOUNTS** |
| 46 | Grant funds were not kept in interest bearing accounts. |
| 78 | Interest earned on grant funds was not remitted timely. |
| 124 | Total - Interest Bearing Accounts |
| | **INTERFUND TRANSFERS** |
| 109 | Grant funds were being transferred between programs. |
| 109 | Total - Interfund Transfers |
| | **FDIC LIMITS** |
| 20 | Grant funds were deposited in unsecured bank accounts with balances that exceeded FDIC limits. |
| 106 | Drawdowns from PMS were untimely or the cash on hand exceeded the cash needed. |
| 126 | Total - FDIC Limits |
| | **MATCHING REQUIREMENTS** |
| 81 | Grantee did not meet the 20 percent matching requirement. |
| 52 | In-kind contributions were inaccurately valued. |
| 95 | Matching documentation was inaccurate or inadequate. |

# FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

| Number of Findings | |
|---|---|
| 5 | Matching findings which did not appear frequently and did not fall under another category. |
| 233 | Total – Matching Requirements |

## GRANT MANAGEMENT

### -- ELIGIBILITY OR ENROLLMENT

| | |
|---|---|
| 58 | Enrollment procedures were inadequate. |
| 49 | Income eligibility verification procedures were inadequate. |
| 2 | Eligibility findings which did not appear frequently and did not fall under another category. |
| 41 | Eligibility of families was inadequately documented. |
| 104 | Student records, student status documentation or families files were inadequate or inaccurate. |
| 254 | Sub-total |

### -- ATTENDANCE

| | |
|---|---|
| 69 | Daily attendant-e requirement was not met. |
| 9 | Attendance records were inadequate. |
| 78 | Sub-total |

### -- SALARIES AND FRINGE BENEFITS

| | |
|---|---|
| 47 | Miscellaneous salary findings. |
| 9 | Unallowable employee bonuses were paid. |
| 46 | Miscellaneous fringe benefit findings. |
| 102 | Sub-total |

### -- UNOBLIGATED FUND BALANCES

| | |
|---|---|
| 49 | Unobligated fund balances were not reprogrammed or returned timely. |

FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

| Number of Findings | |
|---|---|
| 9 | Unobligated fund balances were not returned when the grantees ceased program participation. |
| 20 | Other fund balance findings which did not appear frequently and did not fall under another category. |
| 78 | Sub-total |
| | -- BUDGET EXCEEDED |
| 73 | Grantee expenditures exceeded the grant award. |
| 73 | Sub-total |
| | -- INDIRECT COSTS |
| | -- SALARIES AND FRINGE BENEFITS |
| 48 | Indirect cost rates were not approved, developed, or correctly utilized. |
| 48 | Sub-total |
| | -- BIDDING |
| 39 | Bidding regulations for purchases were not followed. |
| 39 | Sub-total |
| | -- PRIOR APPROVAL |
| 38 | Required prior approval was not obtained for property expenditures. |
| 38 | Sub-total |
| | -- OTHER COST ISSUES |
| 247 | Program expenditures unauthorized or other cost findings which did not appear frequently and did not fall under another category. |
| 37 | Program costs were allocated to an improper grant period. |
| 6 | Related party transactions occurred. |
| 290 | Sub-total |
| 1,000 | Total – Grant Management |

## FINDINGS IDENTIFIED IN NONFEDERAL AUDIT REPORTS

| Number of Findings | |
|---|---|
| | **FACILITIES** |
| 38 | Centers were not meeting State or local licensing requirements or were not in compliance with the fire, health and safety performance standards. |
| 20 | Instances of facility noncompliance include inadequate insurance coverage and no prior approval for renovation expenditures. |
| 58 | Total - Facilities |
| | **SALES TAX** |
| 6 | Sales tax exemptions were not used or refunds were remitted untimely. |
| 6 | Total - Sales Tax |
| | **OTHER** |
| 309 | Compliance findings which did not appear frequently and did not fall under another category. |
| 309 | Total - Other |
| 4,027 | TOTAL FINDINGS REVIEWED |

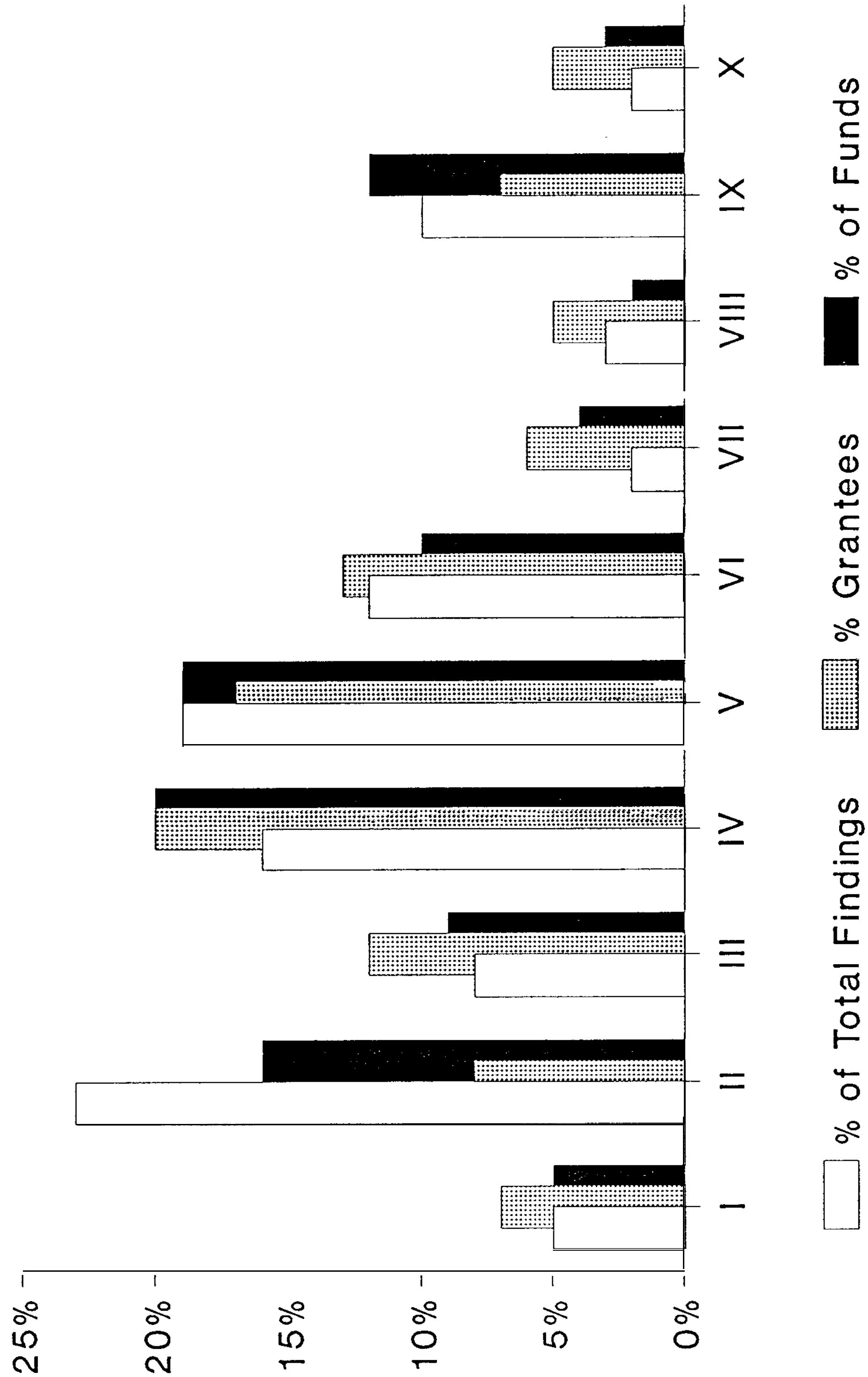
Appendix B

# Geographical Distribution of Review Statistics

GEOGRAPHICAL DISTRIBUTION OF REVIEW STATISTICS

| | PERCENT BY REGION | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | V | VI | VII | VIII | IX | X | TOTAL PERCENT | TOTAL AMOUNT |
| HEAD START EXPENDITURES FOR REPORTS REVIEWED | 3 | 25 | 9 | 16 | 20 | 10 | 2 | 2 | 10 | 1 | 100 | $1,424,908,341 |
| TOTAL EXPENDITURES FOR REPORTS REVIEWED | 6 | 6 | 8 | 14 | 30 | 15 | 2 | 9 | 7 | 3 | 100 | $7,822,754,505 |
| FUNDING IN 1989 | 5 | 16 | 9 | 20 | 19 | 10 | 4 | 2 | 12 | 3 | 100 | $1,110,177,035 |
| GRANTEES IN 1989 | 7 | 8 | 12 | 20 | 18 | 13 | 6 | 5 | 7 | 5 | 100 | 1,164 |
| REPORTS REVIEWED | 6 | 16 | 9 | 15 | 19 | 14 | 3 | 6 | 9 | 4 | 100 | 1,262 |
| FINDINGS REVIEWED | 5 | 23 | 8 | 16 | 19 | 12 | 2 | 3 | 10 | 3 | 100 | 4,027 |

Regional Summary - Total Findings
Percentage Comparisons



Appendix C

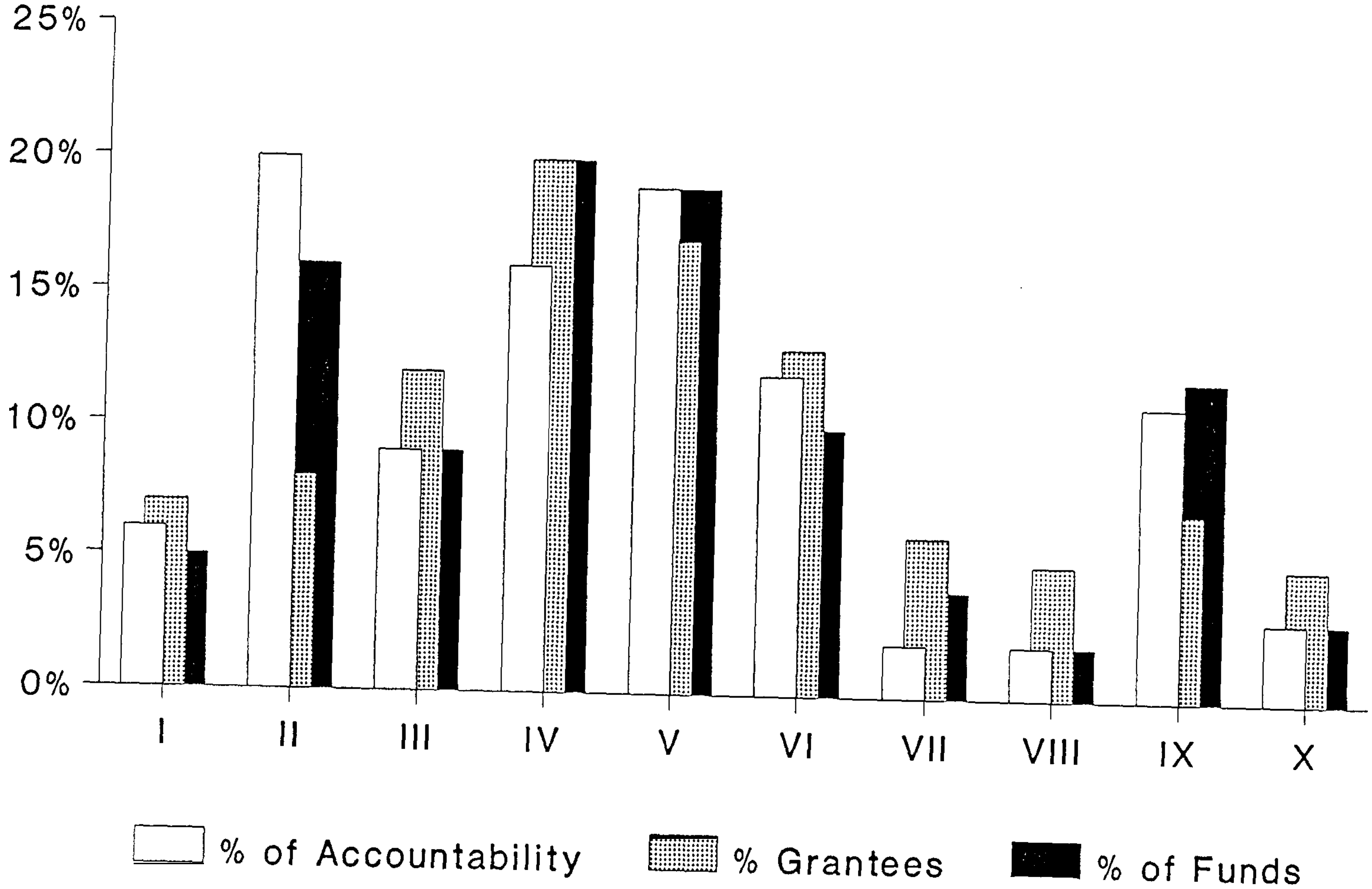
# Geographical Distribution of Finding Categories

# GEOGRAPHICAL DISTRIBUTION OF FINDING CATEGORIES

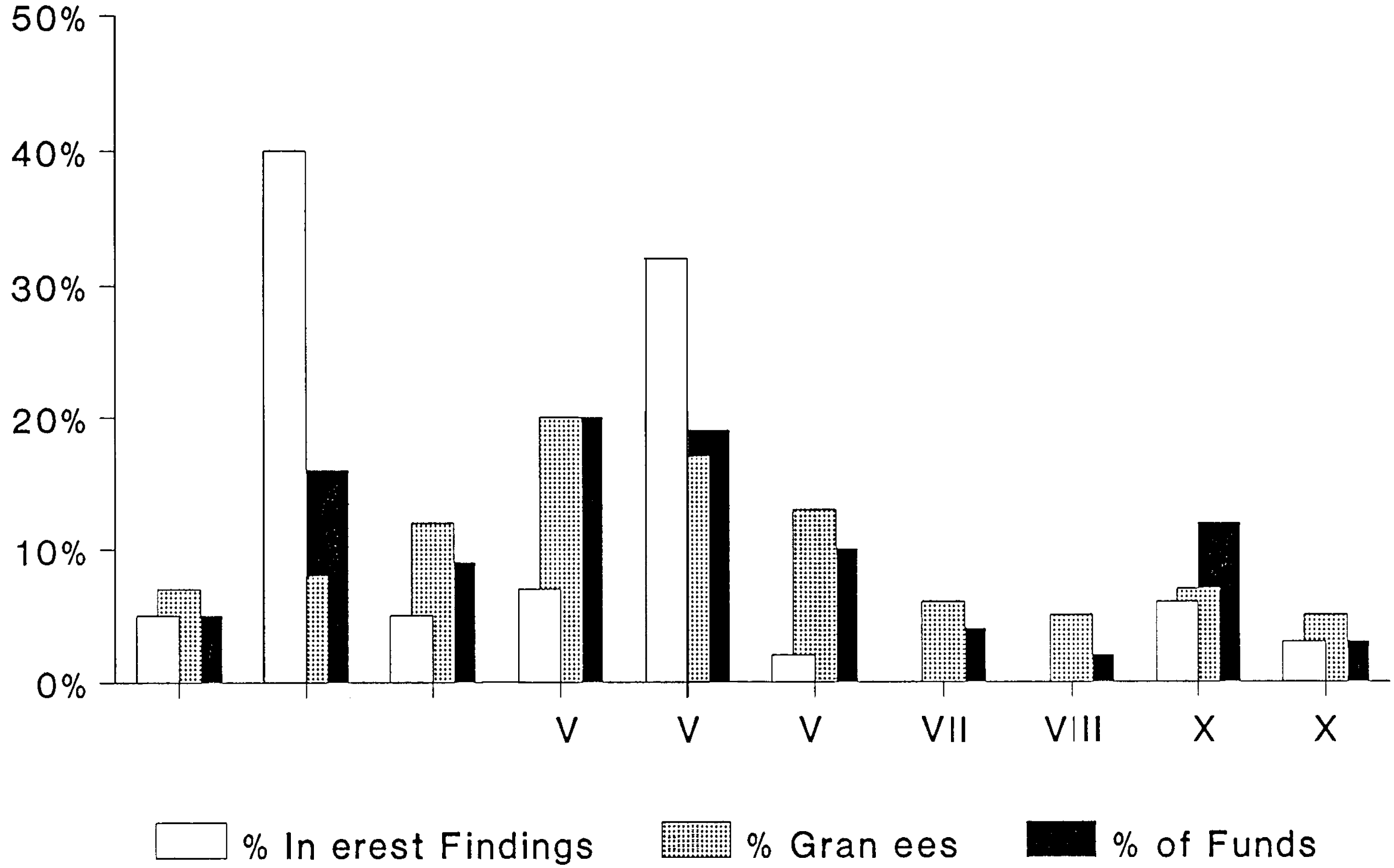
## BY REGION

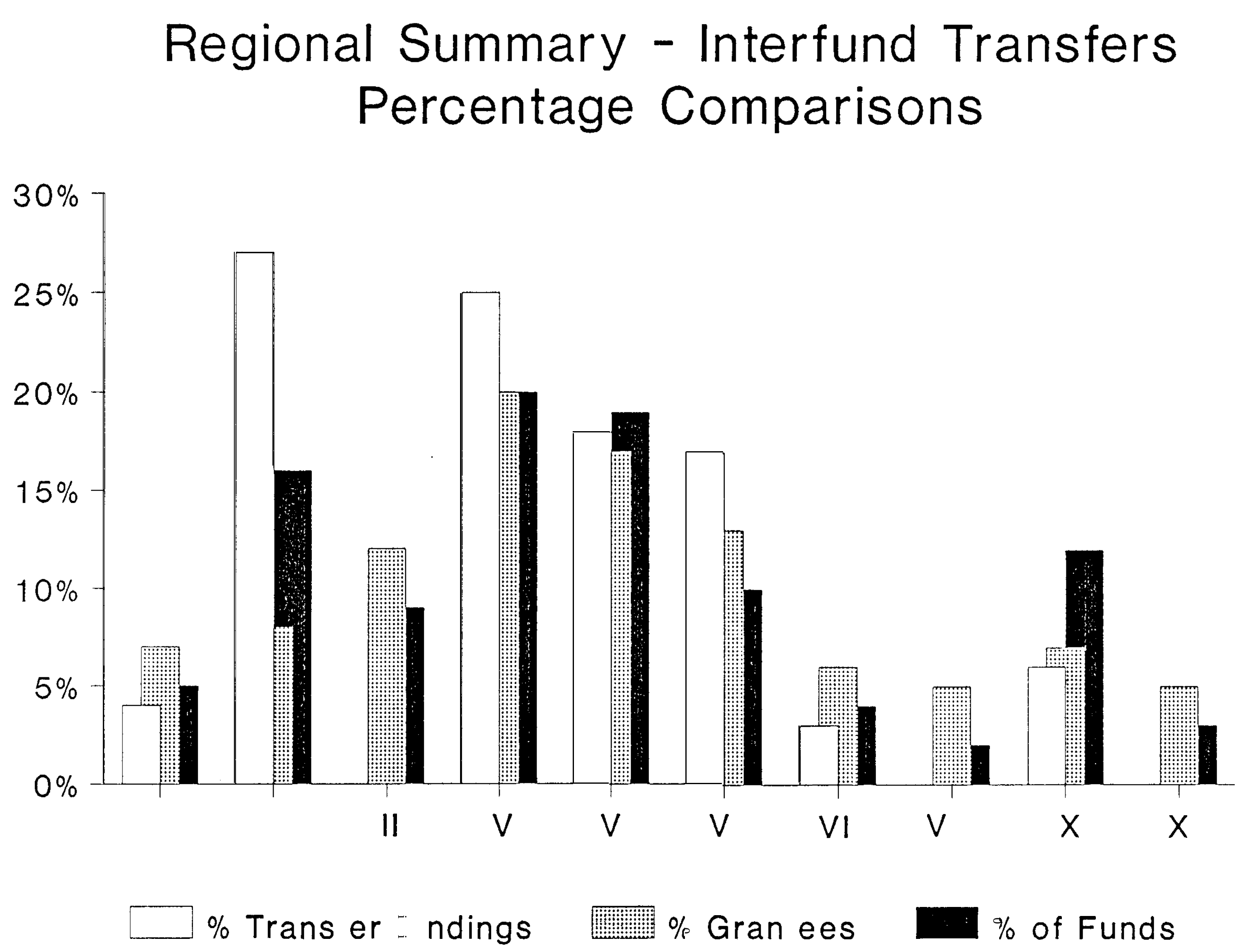
| | PERCENT BY REGION | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | V | VI | VII | VIII | IX | X | TOTAL PERCENT | TOTAL AMOUNT |
| FUNDING IN 1989 | 5 | 16 | 9 | 20 | 19 | 10 | 4 | 2 | 12 | 3 | 100 | $1,110,177,035 |
| GRANTEES IN 1989 | 7 | 8 | 12 | 20 | 18 | 13 | 6 | 5 | 7 | 5 | 100 | 1,164 |
| TYPE OF FINDING | | | | | | | | | | | | |
| ACCOUNTABILITY | 6 | 21 | 9 | 16 | 19 | 12 | 2 | 2 | 11 | 3 | 100 | 2,062 |
| INTEREST BEARING ACCOUNTS | 5 | 40 | 5 | 7 | 31 | 2 | 0 | 0 | 6 | 3 | 100 | 124 |
| INTER-FUND TRANSFERS | 4 | 28 | 0 | 25 | 18 | 17 | 3 | 0 | 6 | 0 | 100 | 109 |
| FDIC LIMITS | 7 | 2 | 8 | 25 | 23 | 14 | 5 | 9 | 6 | 2 | 100 | 126 |
| MATCHING REQUIREMENTS | 4 | 12 | 9 | 24 | 15 | 16 | 2 | 6 | 7 | 3 | 100 | 233 |
| GRANT MANAGEMENT--ELIGIBILITY | 4 | 7 | 8 | 17 | 17 | 15 | 5 | 8 | 18 | 3 | 100 | 254 |
| GRANT MANAGEMENT--ATTENDANCE | 13 | 10 | 17 | 14 | 5 | 13 | 3 | 4 | 14 | 8 | 100 | 78 |
| GRANT MANAGEMENT--OTHER | 3 | 17 | 5 | 14 | 28 | 13 | 1 | 5 | 12 | 2 | 100 | 668 |
| FACILITIES | 5 | 12 | 21 | 16 | 3 | 24 | 0 | 0 | 17 | 2 | 100 | 58 |
| SALES TAX | 0 | 0 | 0 | 83 | 17 | 0 | 0 | 0 | 0 | 0 | 100 | 6 |
| OTHER | 1 | 74 | 3 | 7 | 4 | 3 | 0 | 1 | 5 | 2 | 100 | 309 |

# Regional Summary - Accountability Percentage Comparisons

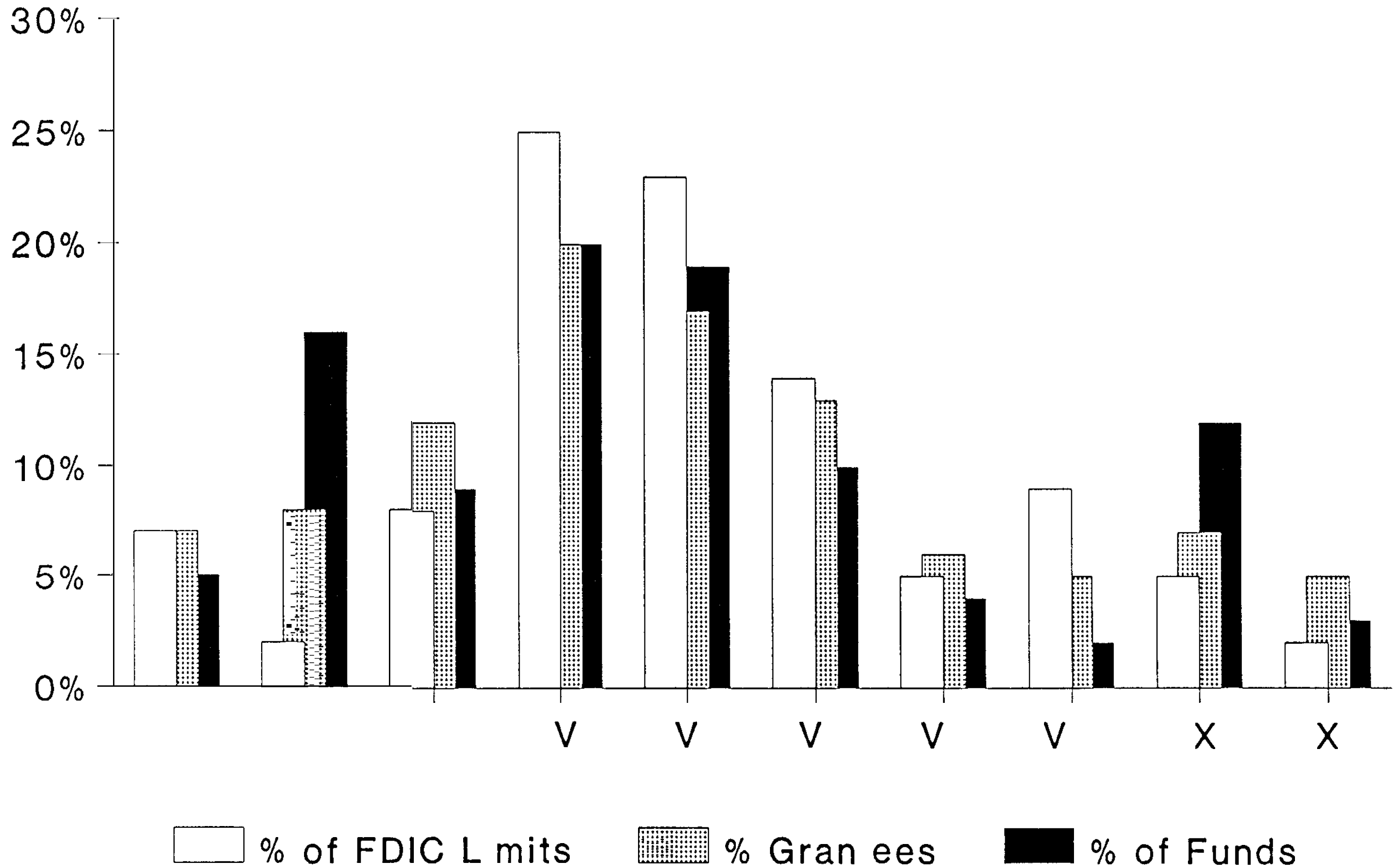


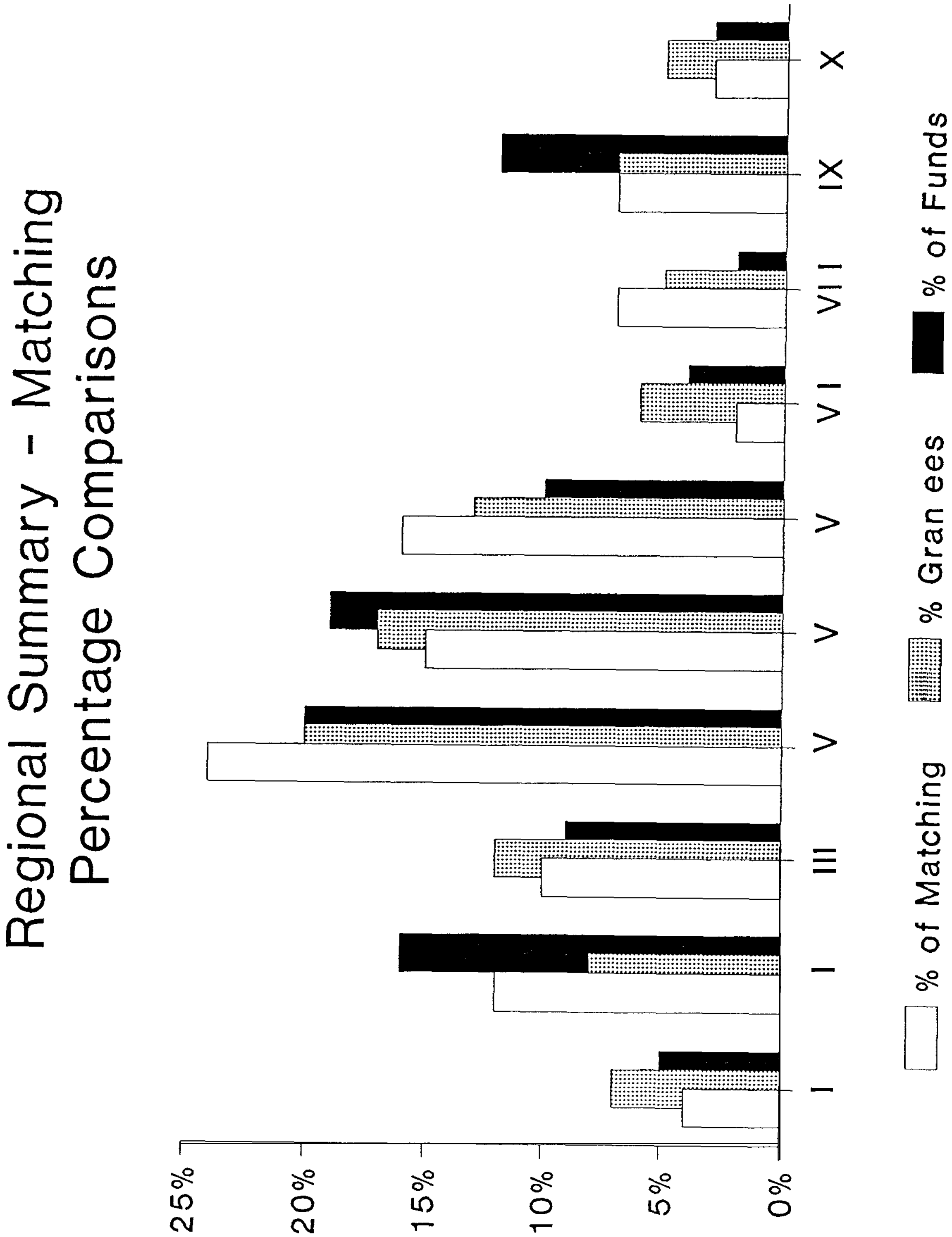
# Regional Summary - Interest Percentage Comparisons



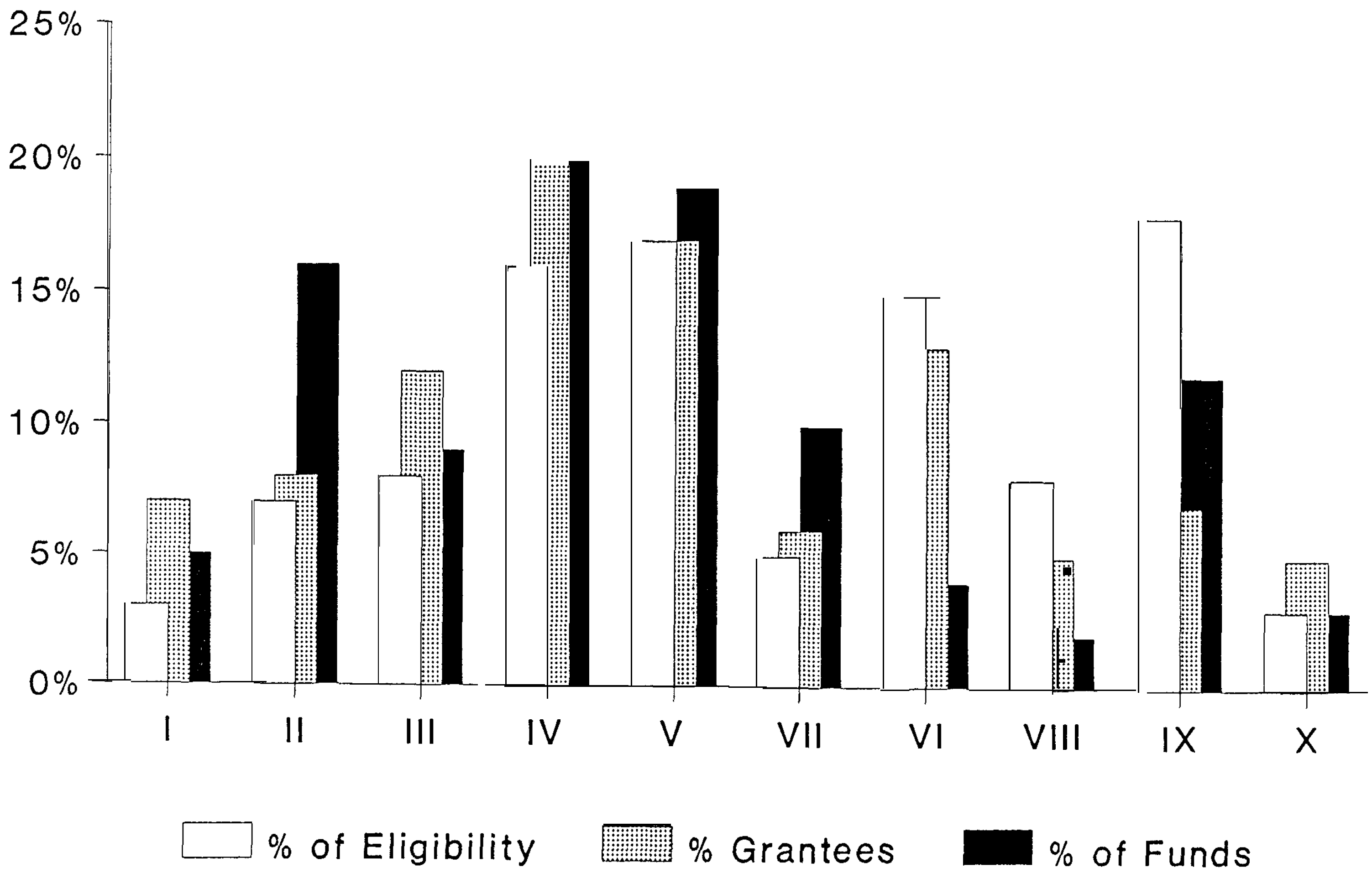

Regional Summary - Interfund Transfers
Percentage Comparisons
30%
25%
20%
15%
10%
5%
0%
II
V
V
V
VI
V
X
X
% Trans er ndings
% Gran ees
% of Funds

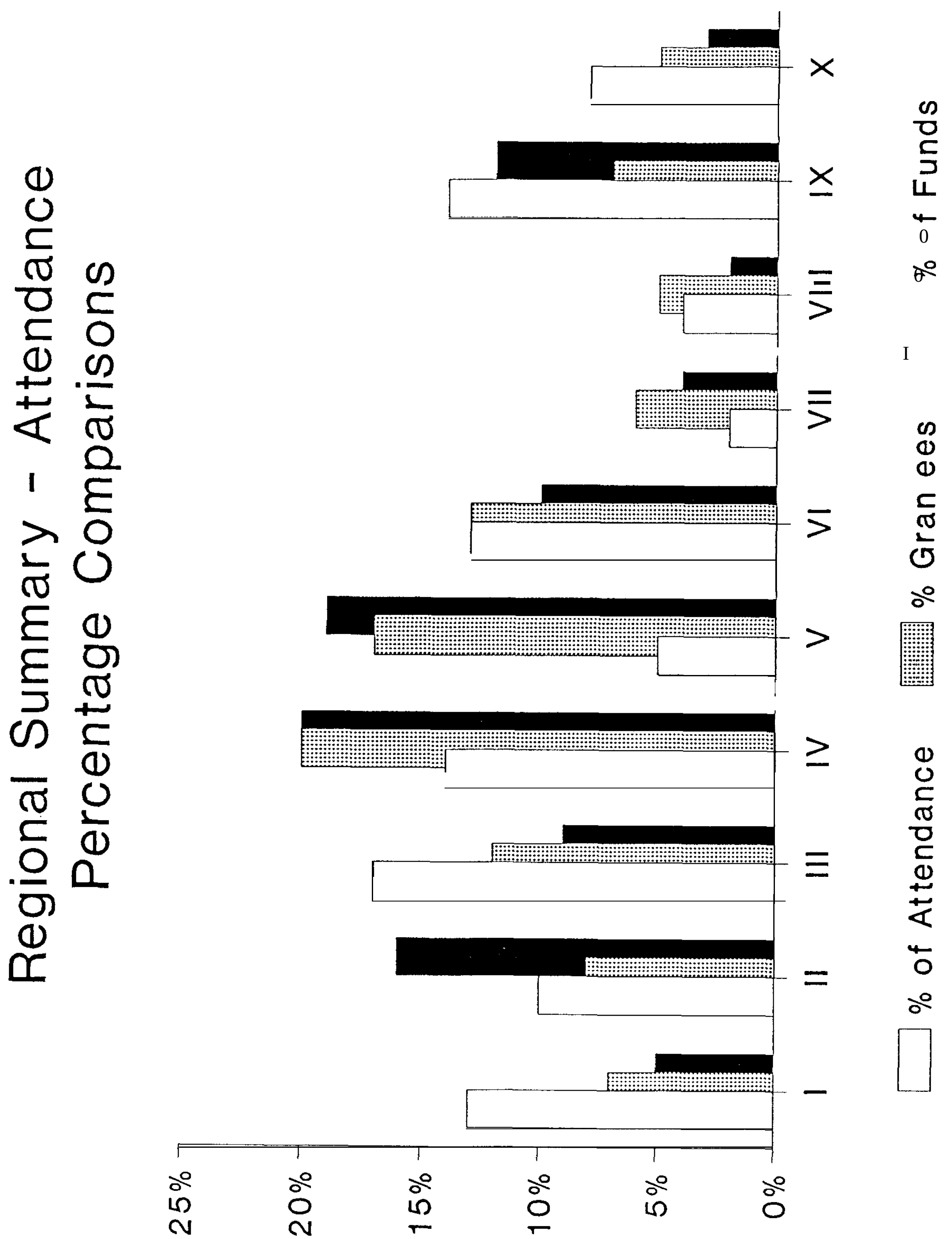
# Regional Summary - FDIC Limits
## Percentage Comparisons



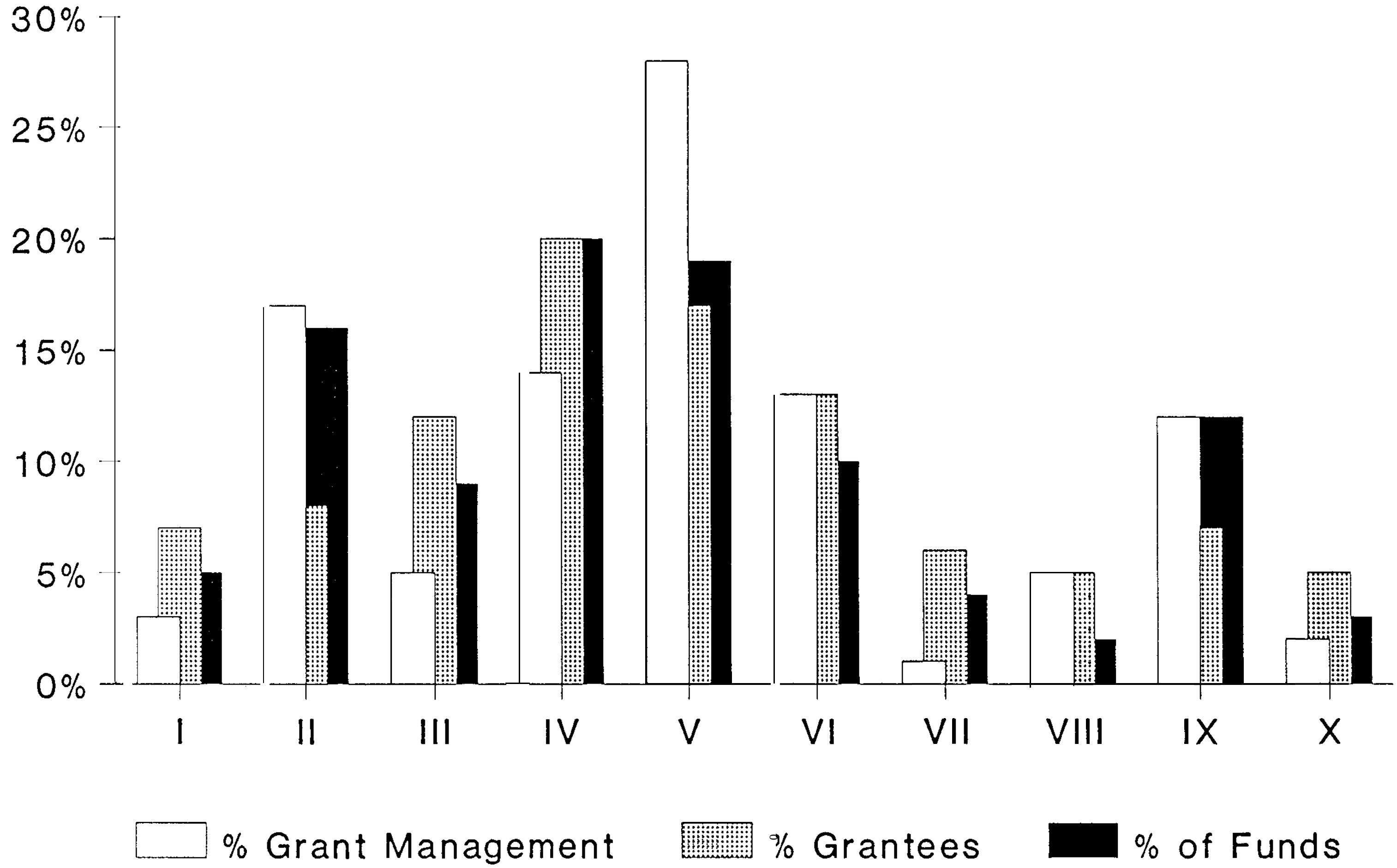

Regional Summary - Matching
Percentage Comparisons
25%
20%
15%
10%
5%
0%
I
I
III
V
V
V
V I
VII
IX
X
% of Matching
% Gran ees
% of Funds

# Regional Summary - Eligibility Percentage Comparisons

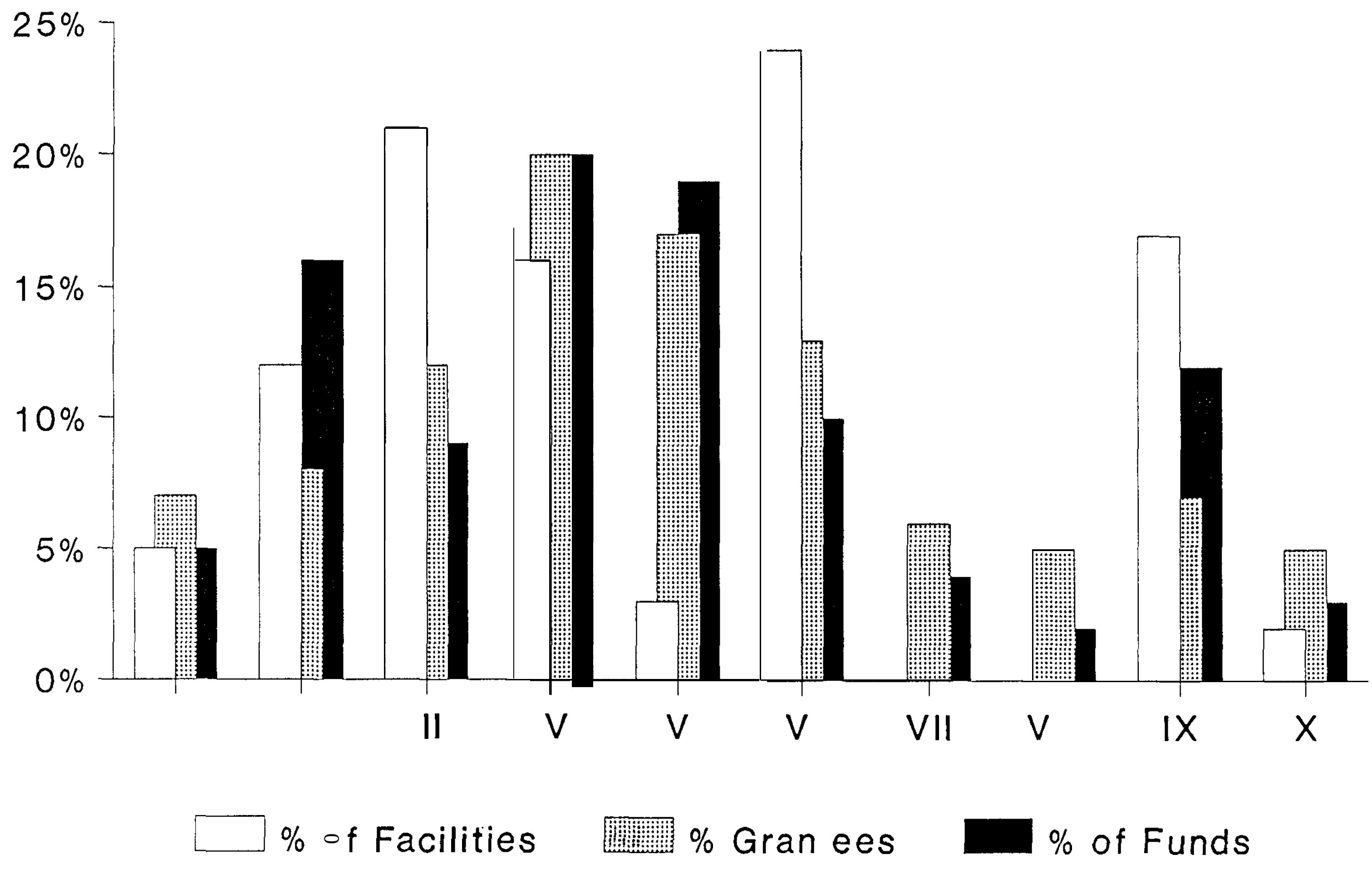



Regional Summary - Attendance
Percentage Comparisons
25%
20%
15%
10%
5%
0%
I
II
III
IV
V
VI
VII
VIII
IX
X
% of Attendance
% Gran ees
% of Funds

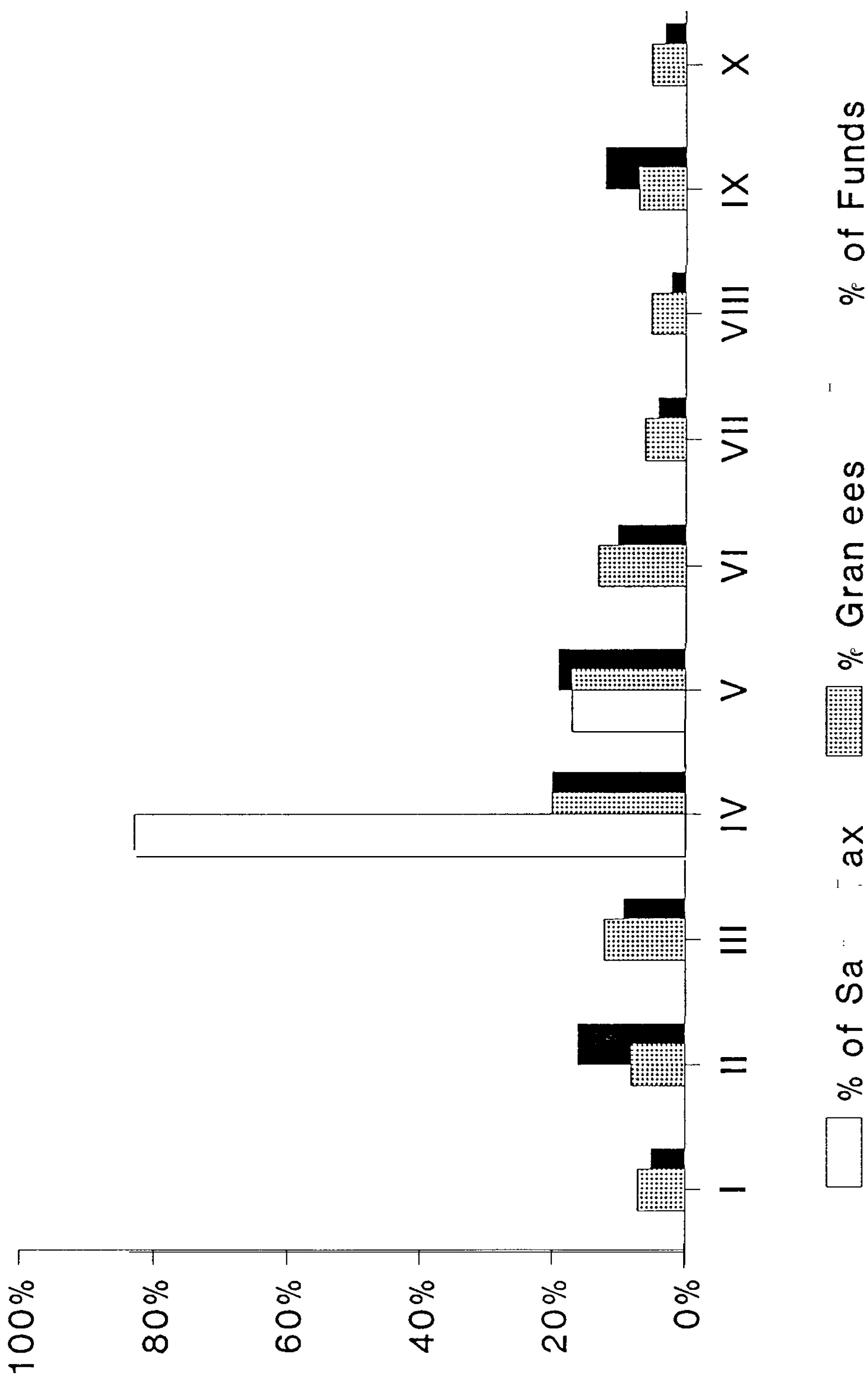
# Regional Summary - Grant Management Percentage Comparisons



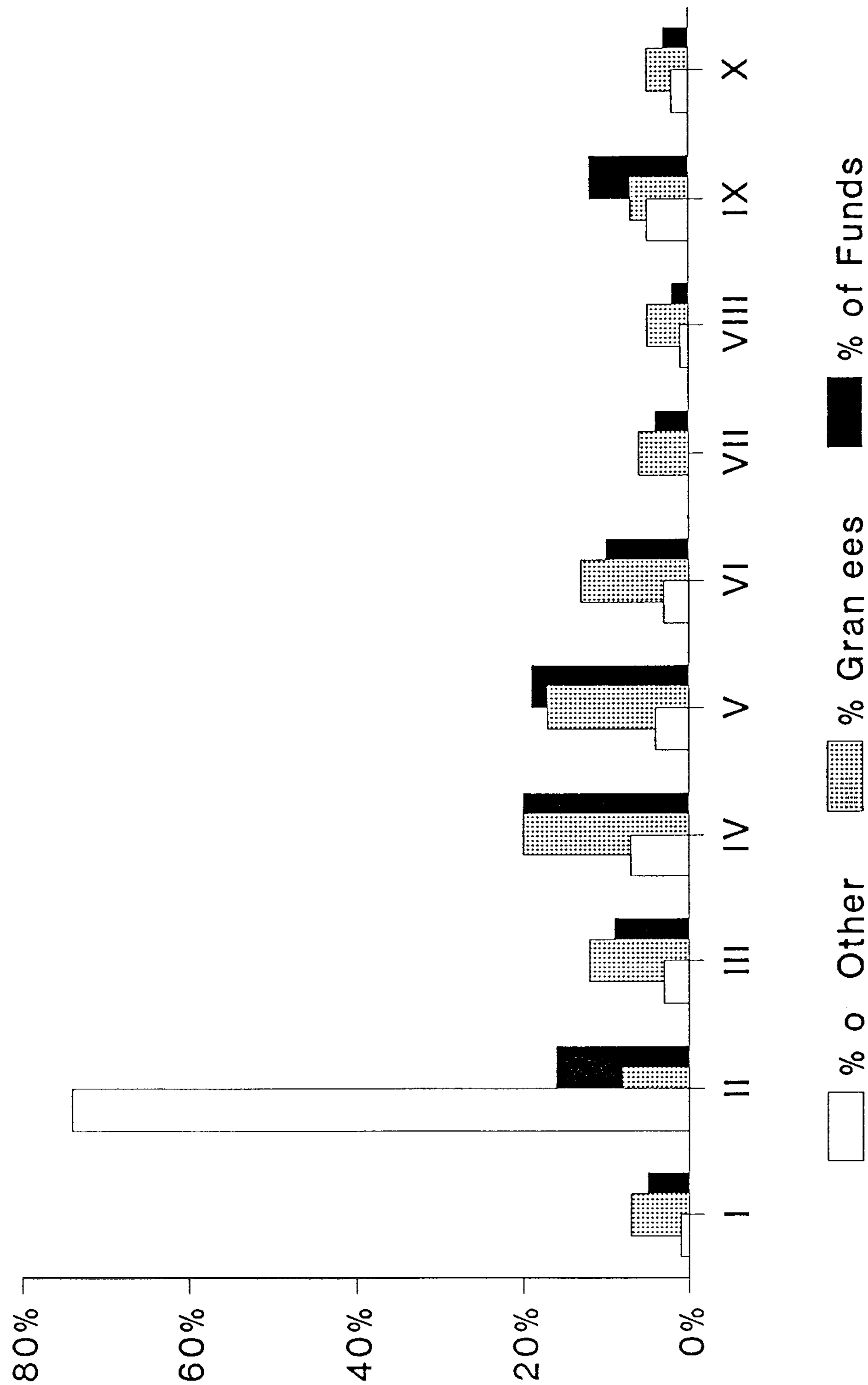
# Regional Summary - Facilities Percentage Comparisons



# Regional Summary - Sales Tax
# Percentage Comparisons



Regional Summary - Other
Percentage Comparisons



Appendix D

# Geographical Distribution of Accountability Findings

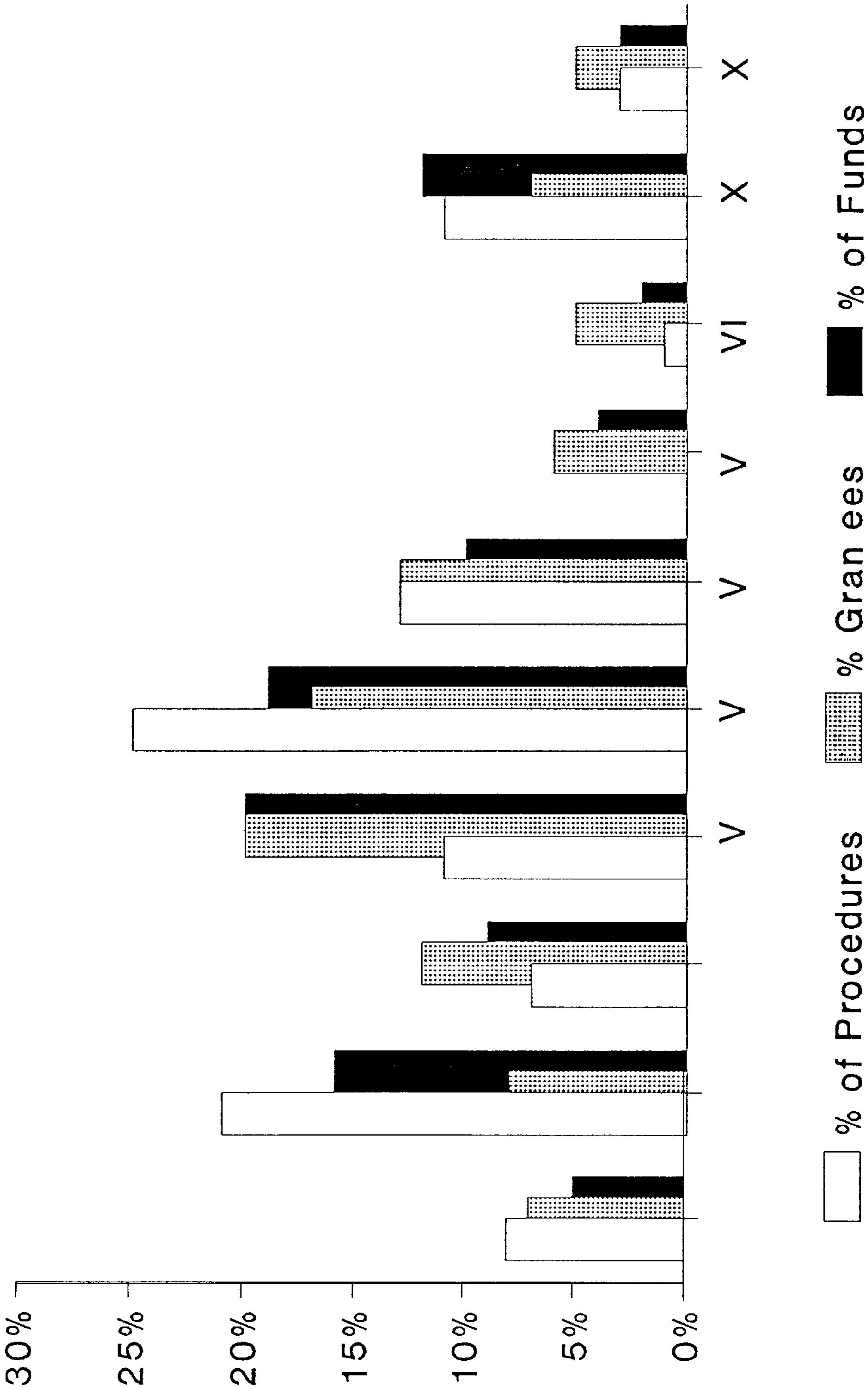
GEOGRAPHICAL DISTRIBUTION OF ACCOUNTABILITY FINDINGS

BY REGION

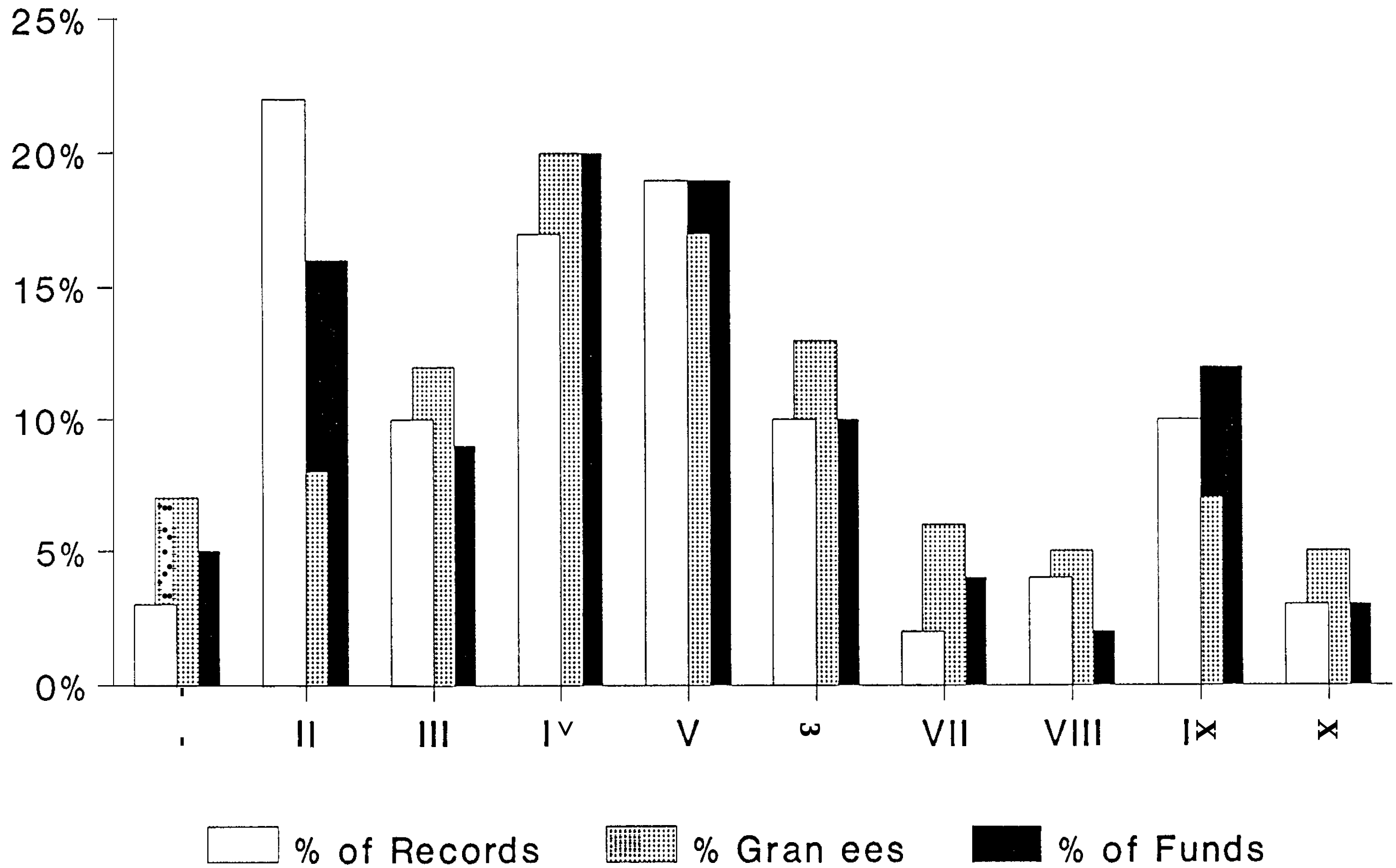
PERCENT BY REGION

| REGION | I | II | III | IV | V | VI | VII | VIII | IX | X | TOTAL PERCENT | TOTAL AMOUNT |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| FUNDING IN 1989 | 5 | 16 | 9 | 20 | 19 | 10 | 4 | 2 | 12 | 3 | 100 | $1,110,177,035 |
| GRANTEES IN 1989 | 7 | 8 | 12 | 20 | 18 | 13 | 6 | 5 | 7 | 5 | 100 | 1,164 |
| TOTAL ACCOUNTABILITY | 6 | 21 | 9 | 16 | 19 | 12 | 2 | 2 | 11 | 3 | 100 | 2,062 |
| INDIVIDUAL ACOUNTABILITY AREAS | | | | | | | | | | | | |
| PROCEDURES | 8 | 21 | 7 | 11 | 25 | 13 | 0 | 1 | 11 | 3 | 100 | 314 |
| ACCOUNTING RECORDS | 3 | 22 | 10 | 17 | 19 | 10 | 2 | 4 | 10 | 3 | 100 | 632 |
| CASH MANAGEMENT | 7 | 11 | 14 | 18 | 19 | 15 | 3 | 1 | 9 | 3 | 100 | 352 |
| FIXED ASSETS | 10 | 21 | 9 | 13 | 22 | 10 | 0 | 2 | 11 | 1 | 100 | 223 |
| TRAVEL | 3 | 14 | 1 | 34 | 15 | 18 | 0 | 0 | 12 | 4 | 100 | 74 |
| BUDGETING | 1 | 44 | 6 | 11 | 14 | 9 | 0 | 0 | 13 | 2 | 100 | 85 |
| TIMELINESS | 8 | 7 | 9 | 0 | 30 | 14 | 4 | 5 | 16 | 7 | 100 | 109 |
| REPORTING | 6 | 34 | 7 | 20 | 5 | 10 | 2 | 2 | 10 | 4 | 100 | 273 |

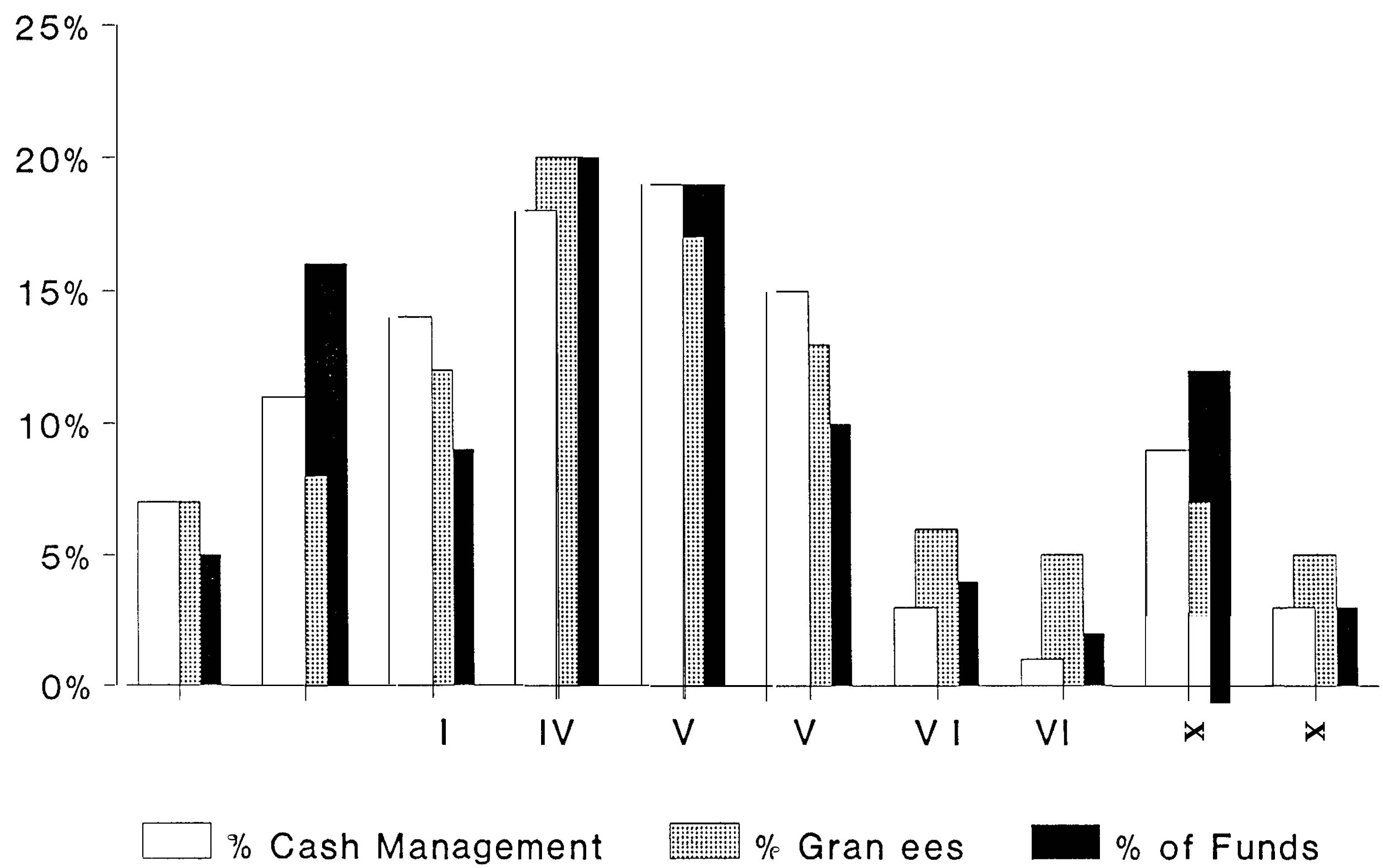
# Regional Summary - Procedures
# Percentage Comparisons



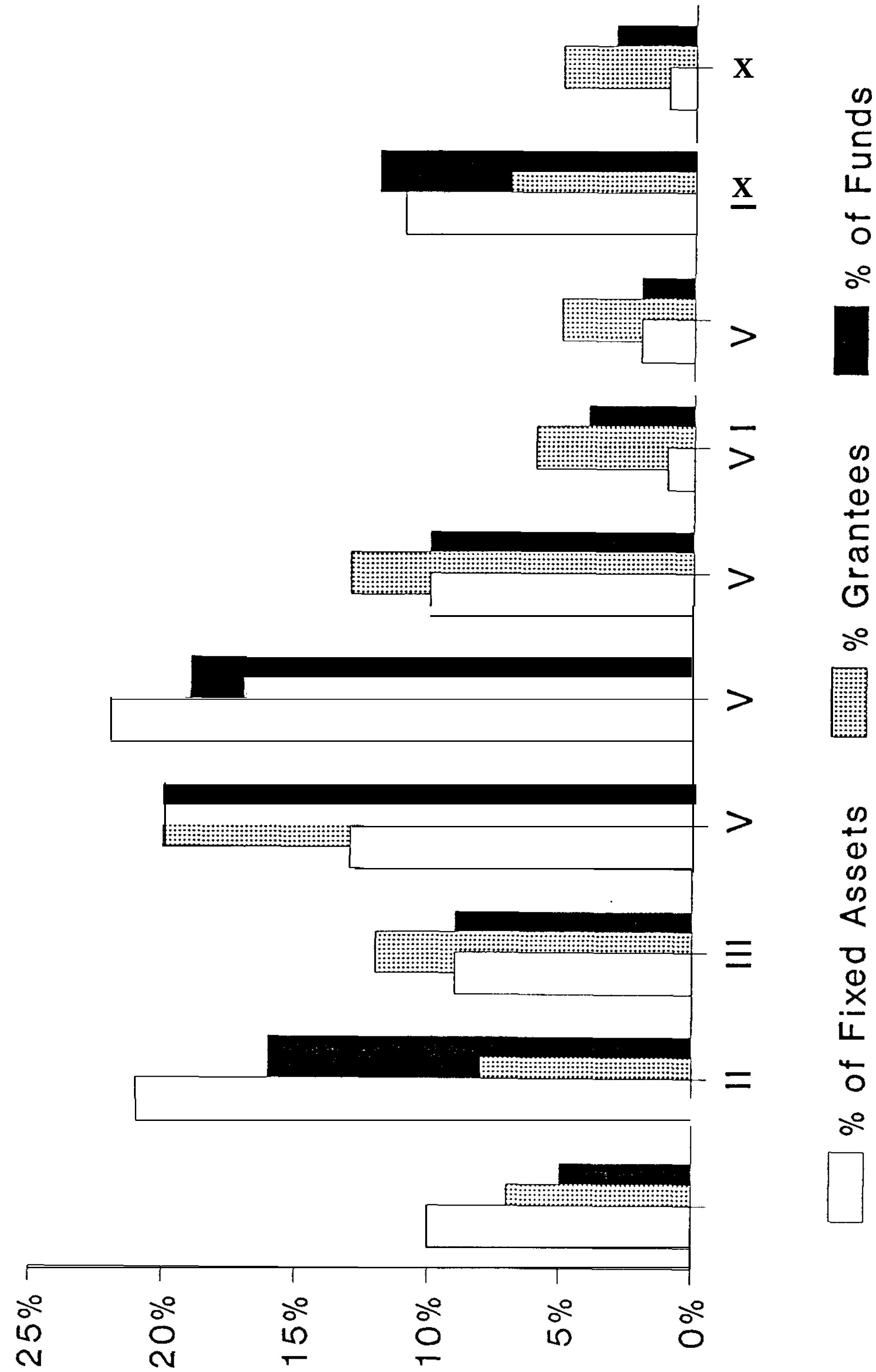
# Regional Summary - Records Percentage Comparisons

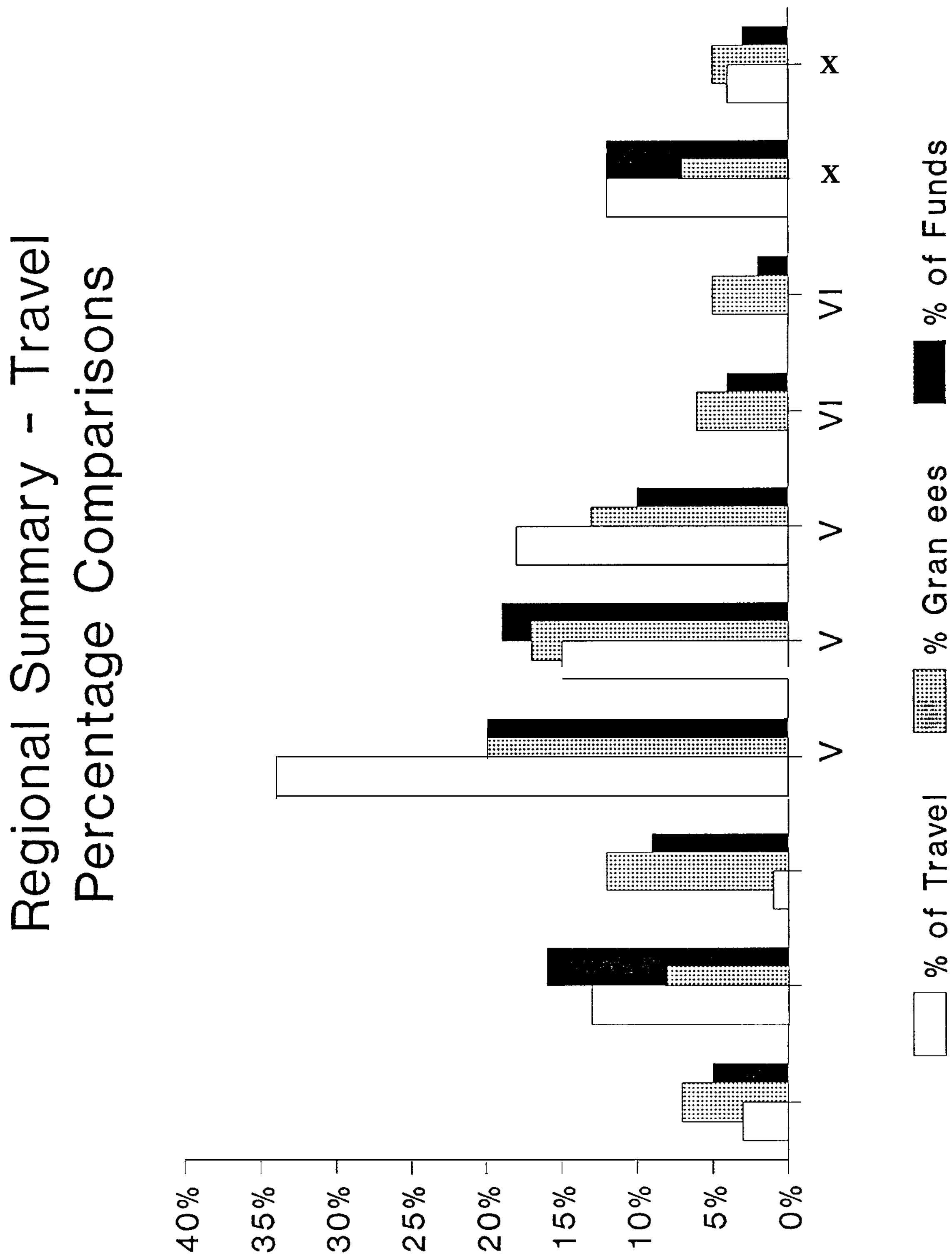


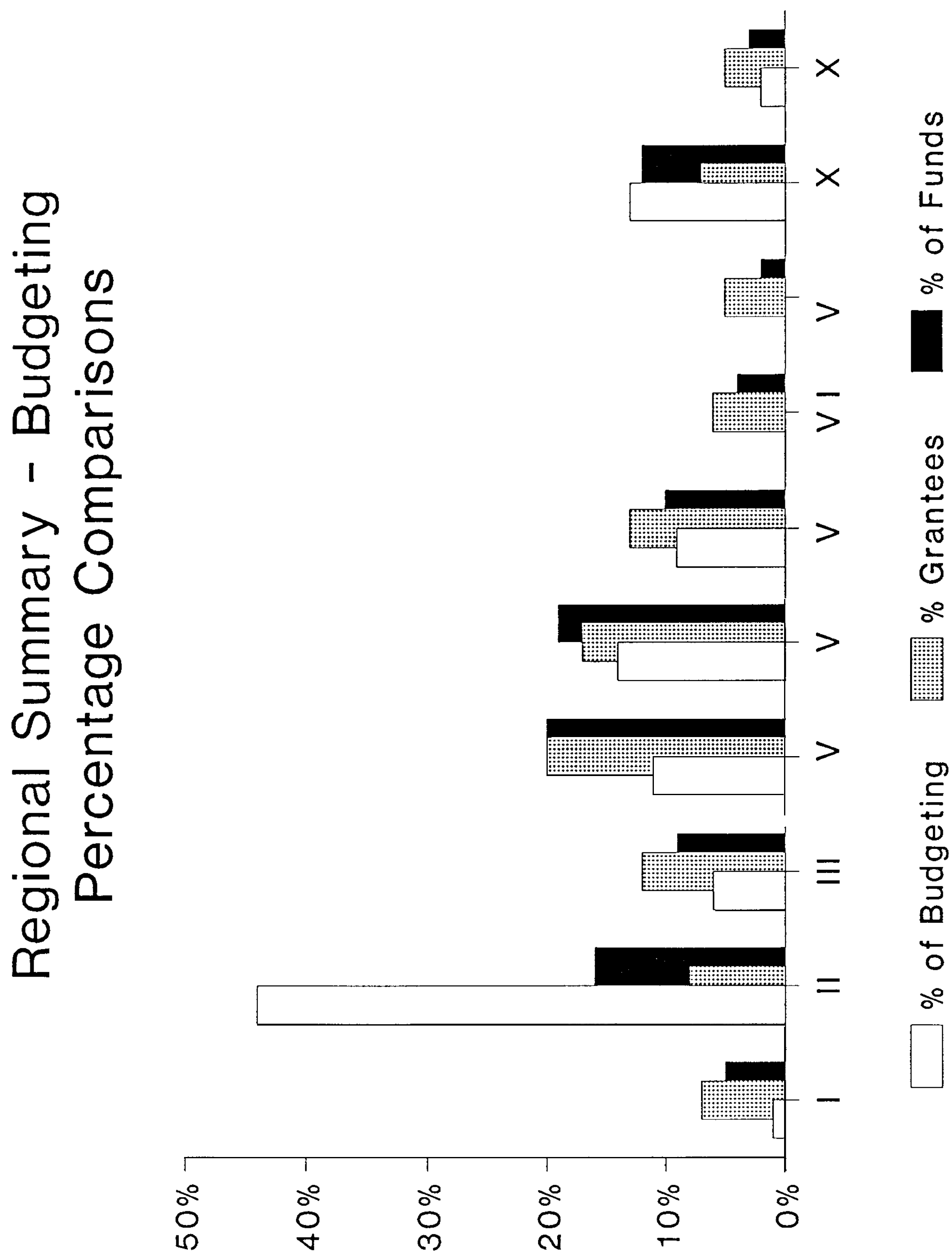
# Regional Summary - Cash Management Percentage Comparisons



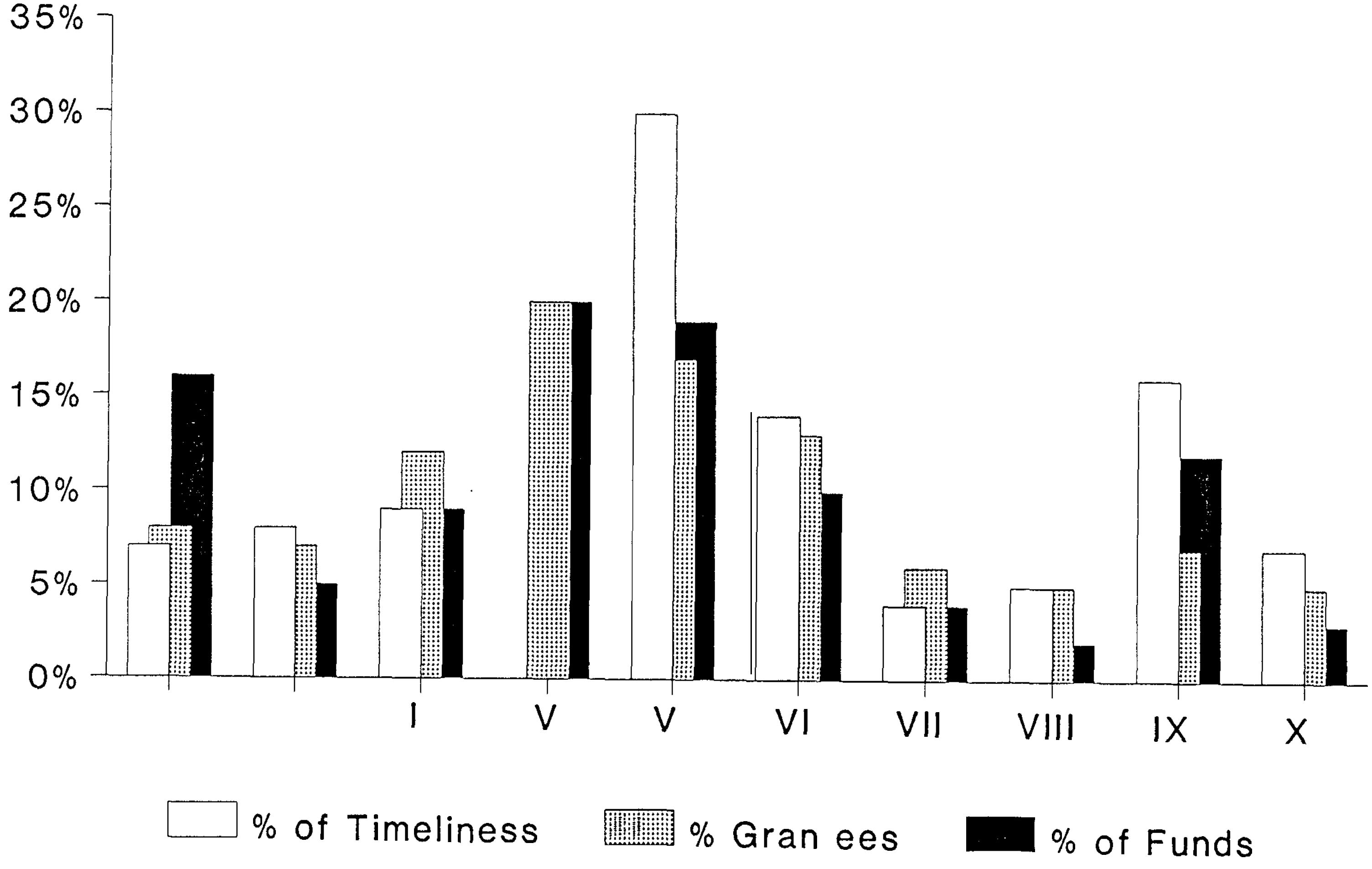
# Regional Summary - Fixed Assets
# Percentage Comparisons



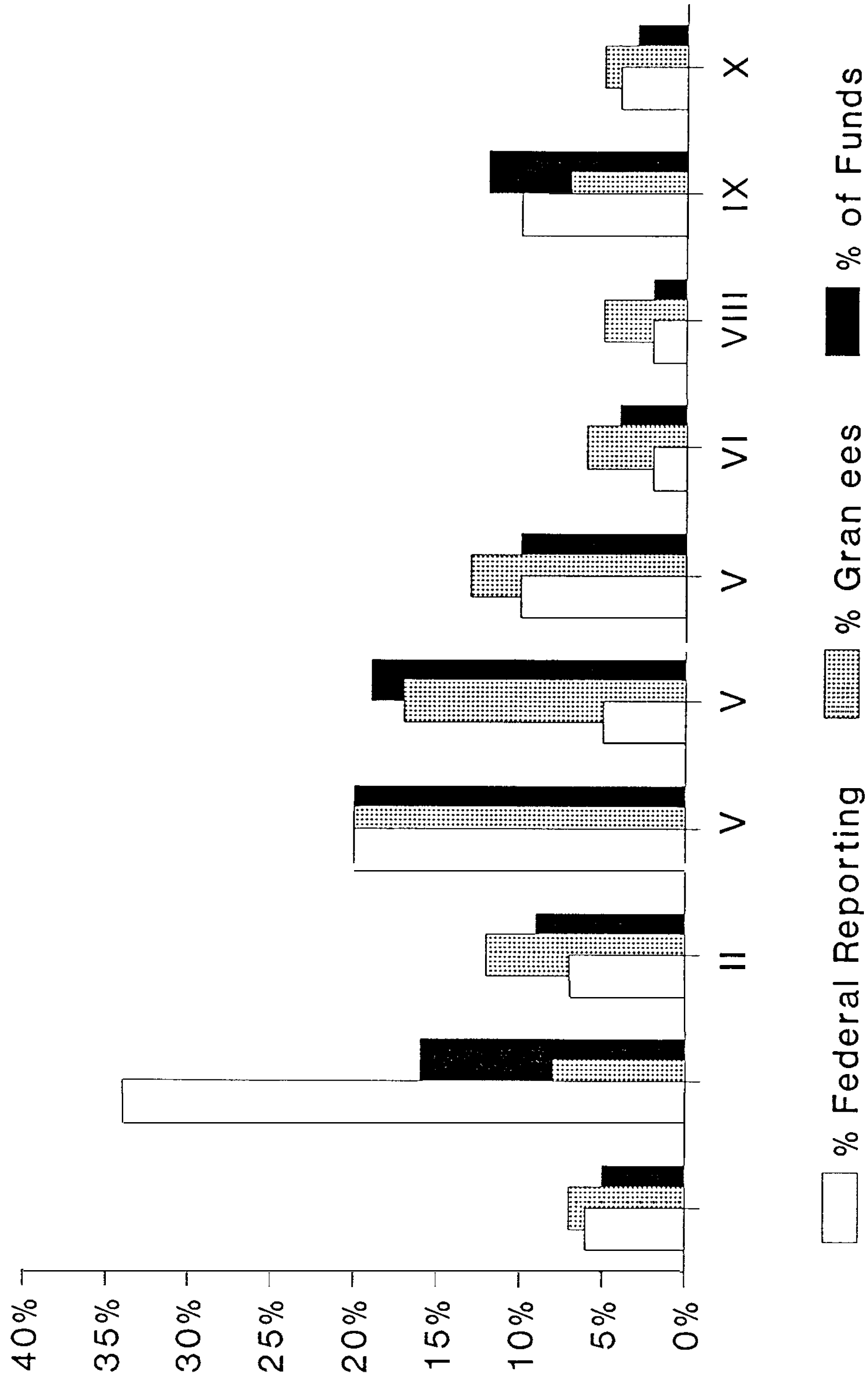

Regional Summary - Travel
Percentage Comparisons
40%
35%
30%
25%
20%
15%
10%
5%
0%
V
V
V
VI
VI
X
X
% of Travel
% Gran ees
% of Funds


Regional Summary - Budgeting
Percentage Comparisons
0%
10%
20%
30%
40%
50%
I
II
III
V
V
V
VI
V
X
X
% of Budgeting
% Grantees
% of Funds

# Regional Summary - Timeliness Percentage Comparisons



# Regional Summary - Federal Reporting Percentage Comparisons



Appendix E

# Distribution of Review Statistics by Type of Grantee

DISTRIBUTION OF REVIEW STATISTICS BY TYPE OF GRANTEE

| | PERCENT BY TYPE OF GRANTEE | | | | | |
|---|---|---|---|---|---|---|
| | NONPROFIT | COMMUNITY ACTION AGENCY | SCHOOL | GOVERNMENT | TOTAL PERCENT | TOTAL AMOUNT |
| HEAD START EXPENDITURES FOR REPORTS REVIEWED | 61 | 21 | 3 | 15 | 100 | $1,424,908,341 |
| TOTAL EXPENDITURES FOR REPORTS REVIEWED | 23 | 10 | 23 | 44 | 100 | $7,822,754,505 |
| GRANTEES PER OUR REVIEW | 56 | 27 | 5 | 12 | 100 | 744 |
| REPORTS REVIEWED | 57 | 27 | 4 | 11 | 100 | 1,262 |
| FINDINGS REVIEWED | 60 | 27 | 3 | 10 | 100 | 4,027 |

Appendix F

# Distribution of Findings by Type of Grantee

DISTRIBUTION OF FINDINGS BY TYPE OF GRANTEE

PERCENT BY TYPE OF GRANTEE

| TYPE OF FINDING | NONPROFIT | COMMUNITY ACTION AGENCY | SCHOOL | GOVERNMENT | TOTAL PERCENT | TOTAL FINDINGS |
|---|---|---|---|---|---|---|
| ACCOUNTABILITY | 62 | 27 | 2 | 9 | 100 | 2,062 |
| INTEREST BEARING ACCOUNTS | 68 | 27 | 3 | 2 | 100 | 124 |
| INTER-FUND TRANSFERS | 58 | 37 | 2 | 4 | 100 | 109 |
| FDIC LIMITS | 57 | 33 | 2 | 8 | 100 | 126 |
| MATCHING REQUIREMENTS | 50 | 28 | 5 | 16 | 100 | 233 |
| GRANT MANAGEMENT--ELIGIBILITY | 45 | 26 | 6 | 23 | 100 | 254 |
| GRANT MANAGEMENT--ATTENDANCE | 51 | 23 | 5 | 21 | 100 | 78 |
| GRANT MANAGEMENT--OTHER | 63 | 27 | 2 | 8 | 100 | 668 |
| FACILITIES | 43 | 3 | 2 | 24 | 100 | 58 |
| SALES TAX | 83 | 17 | 0 | 0 | 100 | 6 |
| OTHER | 61 | 27 | 1 | 11 | 100 | 309 |

Appendix G

# Distribution of Accountability Findings by Type of Grantee

DISTRIBUTION OF ACCOUNTABILITY FINDINGS
BY TYPE OF GRANTEE

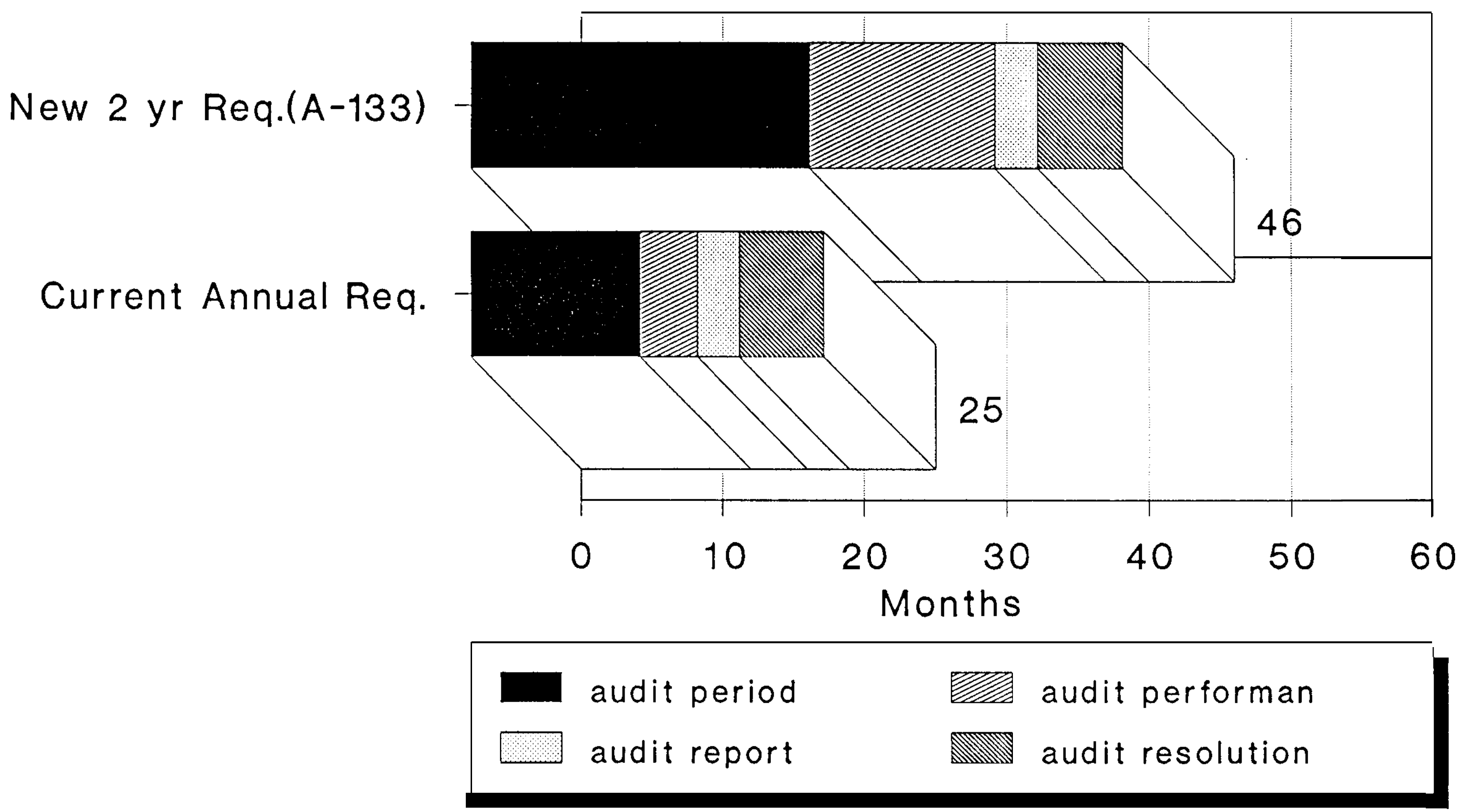
PERCENT BY TYPE OF GRANTEE

| | NONPROFIT | COMMUNITY ACTION AGENCY | SCHOOL | GOVERNMENT | TOTAL PERCENT | TOTAL AMOUNT |
|---|---|---|---|---|---|---|
| TOTAL ACCOUNTABILITY | 62 | 27 | 2 | 9 | 100 | 2,062 |
| INDIVIDUAL ACCOUNTABILITY AREAS | | | | | | |
| PROCEDURES | 65 | 27 | 1 | 6 | 100 | 314 |
| ACCOUNTING RECORDS | 60 | 28 | 2 | 9 | 100 | 632 |
| CASH MANAGEMENT | 62 | 30 | 3 | 5 | 100 | 352 |
| FIXED ASSETS | 64 | 29 | 2 | 6 | 100 | 223 |
| TRAVEL | 65 | 23 | 1 | 11 | 100 | 74 |
| BUDGETING | 72 | 18 | 1 | 9 | 100 | 85 |
| TIMELINESS | 52 | 20 | 3 | 25 | 100 | 109 |
| REPORTING | 63 | 23 | 3 | 11 | 100 | 273 |

Appendix H

# Time Lapse Comparison – Nonfederal Head Start Audits

# Time Lapse Comparison
## Nonfederal Head Start Audits




Period before receipt of audited amounts

Appendix I

# ACF Response

DEPARTMENT OF HEALTH & HUMAN SERVICES

ADMINISTRATION FOR CHILDREN AND FAMILIES
Office of the Assistant Secretary, Suite 600
370 L'Enfant Promenade, S.W.
Washington, D.C. 20447

October 8, 1991

TO: Richard P. Kusserow
Inspector General
Department of Health and Human Services

FROM: Jo Anne B. Barnhart
Assistant Secretary
for Children and Families

SUBJECT: Comments on OIG Draft Management Advisory Report--
Summarization of Head Start Grantee Audit Findings
(A-07-91-00425)

This memorandum transmits the Administration for Children and Families' comments on your draft report on Head Start audit findings.

We are in agreement with nine of the twelve recommendations presented in your report concerning the need to increase training and technical assistance to grantees, specifically in the area of financial management, and the need to continuously upgrade our capacity to effectively monitor grantees. We are fully committed to improving the financial management systems and accountability of Head Start grantees. We have concerns, discussed later in our comments, about three recommendations: 1) developing alternative procedures for timely grant closeout, 2) implementing OMB Circular A-133, and 3) procedures to ensure amounts in excess of FDIC limits.

We have provided specific comments on each of the report's recommendations. We have grouped the recommendations and comments by subject matter and, since this does not always follow the order in which they appear in the report, we have provided the page number on which each recommendation is made.

Thank you again for the opportunity to respond to the concerns raised in the report. As noted above, we are in general agreement with the report's recommendations, and we expect to see considerable progress over the next several months in implementing most of these recommendations. If I can be of further assistance in this regard, please let me know.

Attachment

Comments

We concur with these recommendations. On August 6-10, 1991, a Head Start Management Institute was conducted in Washington, DC. The Institute was attended by 1,574 Head Start Directors from local programs across the country, as well as 82 Regional Office staff and 40 Head Start Bureau staff. The agenda included a total of 99 workshops, nine of which were devoted exclusively to financial management.

Phase II of the Management Institute is now underway. In this phase each Regional Office, in conjunction with its training and technical assistance Regional Resource Center, is responsible for conducting a Management Institute follow-up conference which focuses on those management issues determined at the August Institute as being most critical. Input Surveys completed at the conclusion of the Institute indicated that financial management was identified as the first priority for the follow-up conferences. Regions will be advised to include such topics as non-Federal share, cash management (including interest income) sales tax exemptions, and interfund borrowing.

The Head Start Resource Centers are also responsible for conducting training conferences for grantees in their respective Regions annually. These conferences will also provide an opportunity to address the compliance issues cited in your report.

On page 3, para. 6, the report notes that grantee "...financial information is not always verifiable because of the lack of sound accounting standards and practices..." This identifies one of the most critical deficiencies that we believe exist in a number of programs. There is a requirement that Head Start agencies must have written procedures for the operation of their financial management system which prescribe the necessary steps to be undertaken, the timetable/cycle for completion, the person responsible, and the checks and balances of the system. One of our goals is to explore the feasibility of developing a model financial management procedures manual which will assist grantee staff in developing and improving their own systems manuals, and which will make clear the importance of maintaining use of the manual on a day-to-day basis.

Approximately 60 new Head Start agencies have been added as a result of the FYs 1990 and 1991 expansions. There is an obvious need, therefore, to focus our training and technical assistance efforts on these new agencies. In this regard, we have begun the process of updating the Head Start Policies Manual, which was first issued in 1984. The Manual is a compilation of regulations, policies, Transmittal Notices, Information Memoranda and Collaborative Agreements applicable to the Head Start program. In addition to updating the contents of the Manual, the format will be changed to facilitate its use. Plans are to reissue the new Manual within the next several months.

In addition, discussions are being held regarding the development of a technical assistance manual which will assist Head Start Directors, especially those new to the program, in understanding grants management and understanding and applying Head Start regulations and policies.

These issues will be thoroughly addressed during the next semi-annual meeting of the Resource Centers scheduled for December 9-11, 1991.

Recommendation

We recommend that the ACF require evidence during the grant application process of current licensing or compliance with all of the facility standards. (p.15)

Comment

We concur with this recommendation. We will work with the Regional Offices in developing procedures to assure that all Head Start centers are fully licensed and meet all State and local licensing standards.

The Administration on Children, Youth and Families has proposed revised grant application instructions for Head Start grantees. Interim instructions were issued on September 10, 1991, pending approval of the final instructions by the Office of Management and Budget (OMB). The new instructions will improve the program narrative statement and will provide more budget detail than is allowed by the eight budget categories included in the Standard Form 424A, Part B. Once approved, the instructions will require grantees to provide information on progress made in meeting program requirements and on plans for improving the management and delivery of services; including specific needs identified through audits, fiscal reports, self-assessments monitoring reports, cost analysis data, Program Information' Report data, and correspondence from the Regional Office. The Head Start requirements for facilities contained in Part 1304.2-3 must be addressed, along with all other Performance Standard requirements.

Recommendation

We recommend that the ACF closely observe the progress being made by the American Institute of Certified Public Accountants and the OMB in formulating required financial statements for nonprofit organizations providing guidance to its grantees when literature is available. (p.9)

Comment

We concur with this recommendation. We recognize the value of a consistent definition of Generally Accepted Accounting Principles for nonprofit organizations. The ACF Grants Office will be asked to monitor this important activity and keep programs abreast of progress.

Recommendations

We recommend that the ACF:

- strengthen procedures to ensure all grantees use interest bearing accounts and properly earn and refund interest income. (p.9)

- develop procedures to detect grantees with interfund transfers. The starting point may be a detailed analyses of the financial statements. (p.10)

- reemphasize to grantees that the non-Federal match is to be properly documented and met. (p.12)

- emphasize the possibility of savings to the Head Start program through use of sales tax exemptions and timely deposits of tax refunds. (p.15)

Comments

We concur with these recommendations. Regional Offices have had audit citations concerning the issue of Head Start funds not being placed in interest bearing accounts as required by Federal regulations and the related issue of grantees not remitting a proportionate share of interest income earned back to the Payment Management System. Corrective action taken by one Regional Office was the establishment of an audit trail to look for interest income once the grantee has been identified in an audit or through local monitoring.

Grants Management Information Letters, presentations at cluster and statewide fiscal seminars and program instruction to Head Start grantees are examples of other means being used by the Regional Offices to bring to the attention of grantees, the actions necessary to correct weaknesses in financial management areas; i.e., the correct procedures with respect to on-hand cash balances, repayment of interfund loans, interest bearing checking accounts, sales tax exemption permits, nonfederal match and timely correction of audit findings.

We are concerned about the recurrence of compliance issues such as those cited in the above recommendations, especially among grantees with many years of experience. Therefore, the above issues will be included on the agenda of the next meeting of the Regional Office of Fiscal Operations Directors.

Recommendation

We recommend that the ACF strengthen procedures to ensure excess cash is not drawn and obtain evidence that legitimate balances in excess of the FDIC limit are collaterally secured when awarding grants. (p.11)

Comment

We do not concur with this recommendation. This finding and recommendation in the report illustrates OIG's misrepresentation of the rules on FDIC limits. Current rules require Federal fiscal officers to insure that legitimate balances in excess of FDIC limits are collaterally secured, however, we know of no such requirement for grantees in either law or Federal regulations.

Recommendations

We recommend that the ACF:

- develop alternative procedures for timely closeout of grants, placing less reliance on the nonfederal audit reports. (p.6)

- implement the new audit requirement, OMB Circular A-133, as this will improve the consistency of audited financial statements. (p.9)

Comments

We are not in full agreement with your recommendations regarding the future usefulness of non-Federal audits and the development of alternative procedures, other than audits, for timely closeout of grants.

Prior to OMB Circular A-133, Head Start audits were due annually, no later than 120 days from the end of the budget period. This allowed adequate time to review the audit and to discuss with the grantee any compliance issues prior to refunding. We are very concerned that the new provision of A-133, which does not require an audit to be completed until 13 months after the end of the two-year budget period, will considerably reduce the value of the audit to us as a management tool. We believe that appropriate non-Federal audit procedures are the correct method for timely closeout of grants. At a minimum, we support a special 120 day time limit on the submission of Head Start audits.

We would also like to look into the possibility of using the flexibility provided in the Circular to require annual program rather than institutional audits of Head Start grantees, where appropriate. We believe separate audit rules regarding Head Start grantees are justified by the unique nature of Head Start which makes necessary some degree of flexibility in the implementation of A-133. To our knowledge, Head Start is the only non-competing continuation discretionary grant program of its kind within the Federal government.

Other discretionary grant programs with specific project periods, usually not longer than three years, may be amenable to the less stringent audit procedures prescribed in the Circular. For Head Start, however, the financial audit is an essential informational tool for managers in making decisions, not only for grant closeout but also for the disposition and reallocation of fund balances, managing the refunding process, focusing monitoring activities and designing technical assistance.

We share your concerns that the provisions of A-133 will not permit Head Start to assure timely grant close-out nor assure proper use of Federal funds. We will continue to explore alternatives which will provide us the information to provide necessary oversight of Head Start grantee financial management.

Technical Comment

In the Introduction on page 1, para. 2, we suggest that the following statement be added: "The Head Start program also funds Indian Tribes and Migrant Organizations through grants issued from the Headquarters Grants Office."