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GRANTEE COMPLIANCE WITH
HEAD START
STATUTORY ADMINISTRATIVE COST LIMIT



OFFICE OF INSPECTOR GENERAL
OFFICE OF ANALYSIS AND INSPECTIONS

DECEMBER 1986

Office of the Inspector General

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This Report

Entitled "Grantee Compliance with Head Start Statutory Administrative Cost Limit," this study was conducted to:

- (1) review Head Start administrative cost levels and trends;
- (2) review the status of existing administrative cost control methods and policies; and,
- (3) review the benefits to the Head Start program of grantee administrative services.

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GRANTEE COMPLIANCE WITH
HEAD START
STATUTORY ADMINISTRATIVE COST LIMIT

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EXECUTIVE SUMMARY

The Inspector General initiated this study in response to concerns voiced by Head Start officials that many Head Start grantees exceed, or may soon exceed, the statutory 15 percent administrative cost limit; that administrative costs are in need of greater control; and, that Head Start programs may not be receiving commensurate grantee administrative services for the dollars paid for these services. The purpose of the study was to: (1) review Head Start developmental and administrative cost levels and trends, including an examination of key factors influencing these cost levels and the percentage of Head Start grantees approaching or possibly exceeding the statutory 15 percent administrative cost limit; (2) review the status of existing administrative cost control methods and policies; and (3) review the benefits to the Head Start program of grantee administrative services.

This study surfaced the following findings:

- There is a moderate, but potentially growing, problem with Head Start grantees equalling or exceeding the statutory 15 percent administrative cost limit.
- Grantee and Office of Human Development Services (OHDS) regional office respondents report that policy governing grantee administrative costs is not clear and explicit.
- Reliable summary statistical data on individual and total Head Start grantee administrative cost levels and trends are not available in either OHDS central or regional offices.
- Independent auditors do not examine grantee compliance with the 15 percent administrative cost limit.
- Nonfederal share (NFS) contributions in excess of 20 percent, included in the total budget against which the 15 percent administrative cost limit is computed, directly affect the amount of Federal funds that can be utilized by grantees for administrative services.
- Grantee and OHDS regional office respondents state that grantee compliance with the 15 percent administrative cost limit may become more difficult in the future.

The Inspector General recommends that OHDS:

- ° Strengthen its analysis of and controls over grantee administrative costs.
- ° Examine its administrative cost policy to provide more explicit standards and examples of administrative costs that will promote a more consistent definition of these costs by grantee and regional OHDS office staff. This clarified policy standard should be issued via regulations.
- ° Secure the necessary Assistant Secretary for Management and Budget (ASMB) and Office of Management and Budget (OMB) clearances to institute systematic reporting of additional administrative cost data, on an exception basis, for selected grantees, and require these grantees to submit a detailed breakdown of administrative costs with their funding applications.
- ° Require grantees to show, on the self-certification form, the projected total amount of administrative costs they expect to incur in operating the Head Start program.
- ° In consultation with ASMB, revise its program regulations to conform to departmental audit policy and notify all Head Start grantees of the Department's audit requirements.
- ° Request, for grantees affected by the Single Audit Act and for grantees exceeding or determined to be at risk of exceeding the 15 percent administrative cost limit, any additional audits which are necessary to carry out its responsibilities to enforce the statutory limit on administrative costs. Before requesting any additional audits, OHDS should coordinate with the OIG Office of Audit (OIG/OA) to determine the most feasible way to obtain the audits and to assure that no functions of the organization-wide audit will be duplicated.
- ° Conduct further study to determine whether or not NFS contributions in excess of 20 percent should be included in the total budget against which the 15 percent limit is computed.

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GRANTEE COMPLIANCE WITH
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I. PURPOSE

The purpose of this program inspection was to: (1) review Head Start developmental and administrative cost levels and trends, including an examination of key factors influencing these cost levels and the percentage of Head Start grantees approaching or possibly exceeding the statutory 15 percent developmental and administrative cost limit; (2) review the status of existing administrative cost control methods and policies; and (3) review the benefits to the Head Start program of grantee administrative services.

II. BACKGROUND

For over 20 years the Head Start program has played a significant role in the effective delivery of comprehensive health, educational, nutritional, social and other services to economically disadvantaged children and their families. The Program is administered by the Administration for Children, Youth and Families (ACYF) within the Office of Human Development Services (OHDS).

By legislation, Federal financial assistance for a Head Start program shall not exceed 80 percent of the approved costs of the Program. However, Federal assistance in excess of 80 percent may be approved if OHDS officials determine that such action is required in furtherance of the purposes of the Program. Nonfederal contributions are to make up the rest of the grantee's Head Start total budget. The grantee shall not be required to obtain nonfederal contributions in excess of 20 percent of the Program's approved costs.

A. STATUTORY ADMINISTRATIVE COST LIMIT

Head Start enabling legislation and pertinent regulations, P.L. 97-35 and 45 CFR 1301.32, prohibit the expenditure of more than 15 percent of the total approved grantee budget (Federal and nonfederal) for the costs of developing and administering a Head Start program. Head Start funding applications in which such

costs exceed this limit are not to be approved by authorizing officials without a waiver, which is not to exceed 12 months in duration. Each initial and subsequent grant application must include a signed certification that developmental and administrative costs do not exceed 15 percent of the total budget. Grantees must also keep records which fully disclose the amount and disposition of financial assistance; the total cost of the project; the amount of that portion of the cost supplied by other sources; and such other records as will facilitate an effective audit and/or OHDS/Health and Human Services (HHS) review. If audits or financial reviews disclose actual grantee developmental and administrative costs in excess of 15 percent of total costs, these costs are to be disallowed, unless authorized by waiver.

B. ADMINISTRATIVE COSTS DEFINED

45 CFR 1301.2 defines developmental and administrative costs as "all costs other than those which are incurred in carrying out the education, health, social service, and parent involvement functions. These costs include, but are not limited to, the personnel and other costs of overall planning, coordination, general program direction, accounting, auditing, bonding, insurance, and the allocated costs of occupying, operating, and maintaining the space utilized for those purposes."

Developmental and administrative costs may be comprised of both direct and/or indirect cost components. Direct costs are those costs specifically incurred for Head Start. Indirect costs are those costs necessary for the operation of the grantee's overall organization, but not incurred for the benefit of any specific program, such as Head Start or Meals on Wheels. Usually, program costs are direct charges and most indirect costs are classified as administrative costs.

III. METHODOLOGY

This program inspection focused on five Federal OHDS regions chosen to provide a diverse sampling of Head Start administrative cost control processes and administrative cost levels. These regions were representative in terms of total grantees (Community Action Agency [CAA] grantees, grantees having indirect cost rates [including a mix of high and low total indirect cost levels]) and total regional funding levels. Additionally, these regions had applied the Head Start Cost Management Instrument (HSCMI) to a significant number of their grantees.

From these five regions we drew a representative sample of 120 grantees. This sample, a 10 percent stratified sample of the universe, reflected the characteristics of the national Head Start grantee population in terms of numbers, types and distribution of grantees. (See Attachment 1 for a profile of regional sample grantees.)

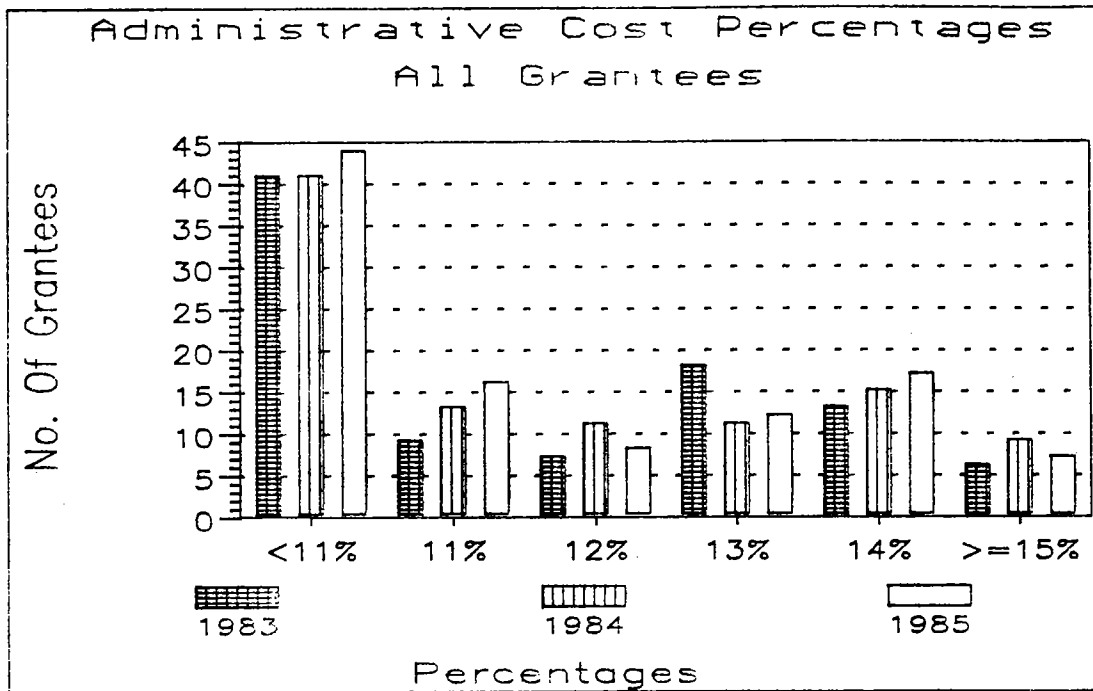
The inspection employed mailout questionnaires to ten regional OHDS offices and to the sample of 120 grantees; on-site visits to four regional offices, where structured interviews were conducted with selected individuals from the offices of OHDS Grants Management and Programs, and the Division of Cost Allocation (DCA); review of regional OHDS grantee files; and telephone interviews with a sample of 67 grantee Head Start directors. The sample of Head Start directors was selected from the 115 grantees who returned completed questionnaires, and reflected the characteristics of the grantee sample.

Following receipt of the mail-out questionnaires, the on-site interviews and records review, and the telephone interviews, OAI performed an in-depth analysis which focused on patterns and trends in Head Start administrative costs. This analysis included: the identification of any grantees exceeding the statutory administrative cost limit, and cost variations due to differences in grantee types, funding levels, regional locations and the effect of indirect costs; a review of the status of existing controls on Head Start administrative costs; and a review of the reported benefits to Head Start of grantee administrative services. In general, summary statistical data on Head Start grantee administrative cost levels and trends were not available in either OHDS central or regional offices. Therefore, administrative cost levels and trends data are based on grantee self-report data. OAI did not perform audits of grantees' records.

IV. FINDINGS AND RECOMMENDATIONS

A. PATTERNS IN ADMINISTRATIVE COST PERCENTAGE LEVELS

Administrative costs as a percentage of total budgets for all sample grantees in 1983, 1984 and 1985:



Graph 1

As shown by Graph 1 and the table following, the number of grantees in various administrative cost levels have remained relatively stable over the last three years. There was, however, an increasing trend in numbers of grantees at the 11 percent and 14 percent levels.

Administrative Cost Percentage	Number of Grantees At Each Administrative Cost Percentage Level							
	1983		1984		1985		3 Year Total	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
< = 11%	41	43.16%	41	40.59%	44	41.90%	126	41.86%
11 - 11.99%	9	9.47	13	12.87	16	15.24	38	12.62
12 - 12.99%	7	7.37	11	10.89	8	7.62	26	8.64
13 - 13.99%	18	18.95	11	10.89	12	11.43	41	13.62
14 - 14.99%	13	13.68	15	14.85	17	16.19	45	14.95
15 - 15.99%	4	4.21	5	4.95	4	3.81	13	4.32
> = 16%	3	3.16	5	4.95	4	3.81	12	3.99
Totals	95	100 %	101	99.99%	105	100 %	301	100 %

TABLE 1

Overall Administrative Cost Percentages

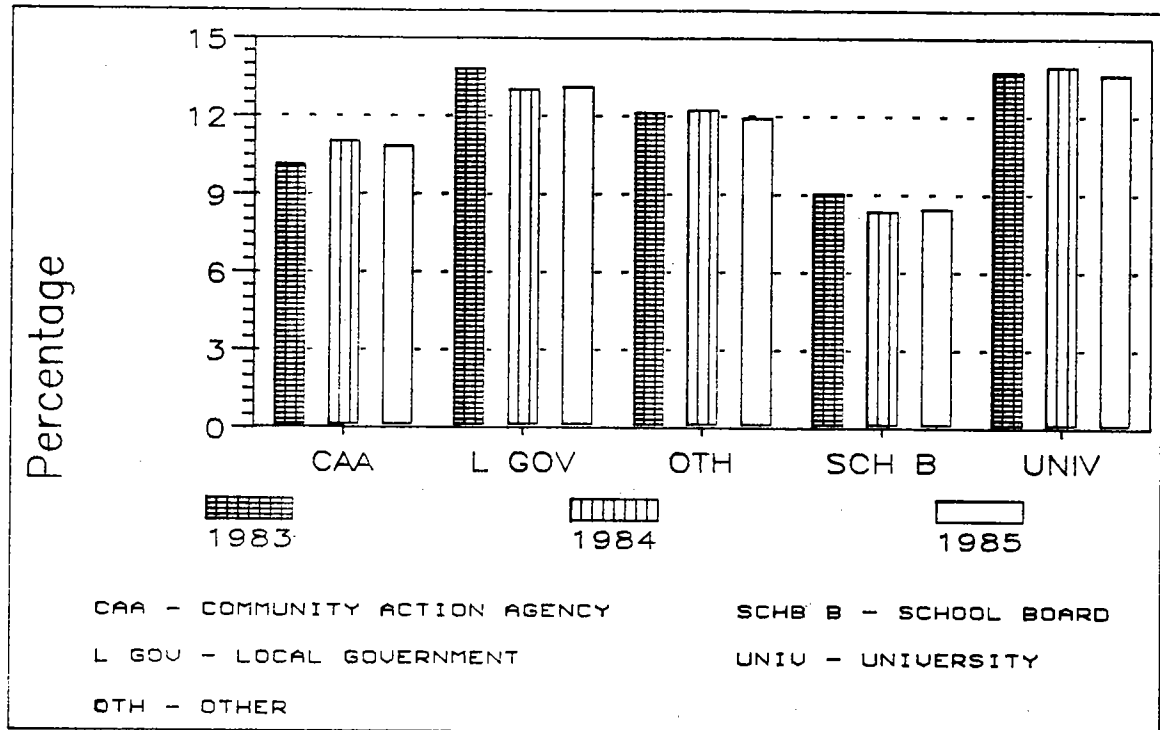
Year	Total Head Start Budget *	Total Head Start Administrative Costs *	Percentage Administrative Costs to Budget
1983	\$ 89.4	\$ 9.6	\$ 10.7%
1984	\$ 102.8	\$ 11.6	\$ 11.3%
1985	\$ 113.5	\$ 12.7	\$ 11.2%

(* In Millions)

TABLE 2

Overall average administrative cost percentages reported by grantees show relatively little change from 1983 to 1985. Total administrative costs of sample grantees were reported to rise by 32% from \$9.6 million in 1983 to \$12.7 million in 1985. However, this rate of increase in administrative costs only slightly exceeded the rate of increase in total grantee budgets of 27%, accounting for only a slight overall rise in the average administrative cost percentage of about 5% for the period of 1983 to 1985.

Administrative Cost Percentages By Grantee Type



Graph 2

An analysis of administrative cost percentages by grantee type shows CAA percentages rose slightly (8.9%) from 1983 to 1984 and then declined slightly in 1985 for a small overall increase of 6.9 percent over the three year period. Administrative cost percentages for all other grantee types either declined slightly or remained unchanged.

Table 3 shows the 3-year average of administrative cost percentages by grantee type. Attachment 2 shows that the relative ranking of administrative cost percentages by grantee type were unchanged over this same period.

Type	No. Grantees	Rank (High To Low)	3 Year Average %
Universities	1	1	13.7%
Local Governments	10	2	13.3%
Other Private Non-Profits	14	3	12.1%
CAAs	81	4	10.6%
Schools	9	5	8.6%

Table 3

It is interesting to note that CAAs, which comprise about three-fourths of all Head Start grantees, report an average overall administrative cost percentage of 10.6 percent, a ranking lower than all other grantee types except schools. Reportedly, schools often simply do not charge Head Start for the full costs of administering the program.

Comparison Of Administrative Cost Percentages For Grantees With And Without Indirect Cost Rates

Year	Type Cost	Total Head Start Budget *	Total Head Start Administrative Costs *	Percentage Administrative Costs to Budget
1983	Direct	\$ 65.2	\$ 7.0	10.7%
	Indirect	\$ 24.2	2.6	10.7%
1984	Direct	\$ 71.4	7.9	11.1%
	Indirect	\$ 31.4	3.8	12.1%
1985	Direct	\$ 76.1	8.2	10.8%
	Indirect	37.4	4.5	12.0%

(* In Millions)

TABLE 4

The overall average of administrative costs as a percentage of total budget for grantees with and without indirect cost rates shows some noteworthy differences, although they do not differ radically. Average administrative cost percentages for grantees with indirect costs are about 10 percent higher than for those without. Also, average administrative cost percentages for grantees having indirect cost rates have risen by 12 percent over the 1983 through 1985 period, whereas direct-cost-only grantees were unchanged.

Average administrative cost percentages for CAAs having approved indirect cost rates for the 3-year period were 11.7 percent or about 16 percent higher than for direct-cost-only CAAs (10.1 percent). The amount of increase in administrative cost percentages for CAAs having indirect costs rose by 12 percent from 1983 to 1985, whereas percentages for CAAs with direct costs only rose by 3 percent. Average administrative cost percentages were also found to be somewhat higher for local government and other private nonprofit grantees with approved indirect cost rates than for grantees with direct costs only (see Attachment 3).

B. TRENDS IN HEAD START ADMINISTRATIVE COSTS

In general, summary statistical data on Head Start grantee administrative cost levels and trends were not available in either OHDS central or regional offices. Partial documentation of administrative cost percentages was available through the HSCMI - a cost management system applied to grantees every third year. However, as discussed below, some of these data were inaccurate and had not been updated to show adjusted administrative cost percentages following regional office - grantee negotiations. Most available administrative cost data are based on prospective or budgeted costs rather than actual or audited costs. Annual grantee independent audits rarely, if ever, examine and document grantee administrative costs. Moreover, grantee self-reported sample data, HSCMI data and regional questionnaire responses on administrative cost levels, particularly for those grantees exceeding the statutory 15 percent limit, do not generally agree.

1. Grantees Equalling Or Exceeding The Statutory Administrative Cost Limit

Data reviewed during this inspection indicate there is a moderate, but potentially growing, problem with grantees equalling or exceeding the statutory administrative cost limit of 15 percent of total budget. Grantee self-report data, including sample grantee questionnaires and Head Start director telephone interviews, regional OHDS questionnaires and HSCMI summary data for 1984 all report grantees exceeding the limit by varying degrees.

a. Grantee Self-Report Data

As shown by Table 1 on page 4, an average of about 1 out of 4, or 23 percent, grantees reported administrative cost levels of 14 percent or higher for the 3-year period. Seven of 95, or 7.4 percent, in 1983; 10 of 101, or 9.9 percent, in 1984; and 8 of 105, or 7.6 percent, in 1985, of the grantees equalled or exceeded the 15 percent limit. This represents an yearly average of 8.3 percent of sample grantees who reported equalling or exceeding the administrative cost limit.

Attachments 4A-4D provide breakdowns of grantees equalling or exceeding the limit by grantee type, regional location, presence or absence of an indirect cost rate and grantee funding level. A total of 25 grantees equalled or exceeded the limit during the 1983 through 1985 period. Of these, 17 or 68 percent were CAAs, 4 or 16 percent were local governments, 3 or 12 percent were other private nonprofits and 1 was a school board. The percentages of CAAs and other private nonprofits over the limit correspond almost exactly with the percentages of these grantees in our sample. The percentage of local governments over the limit is double their representation in our sample.

Of grantees equalling or exceeding the limit, 17 or 68 percent were grantees without indirect cost rates and 8 or 32 percent had approved indirect cost rates. These figures correspond quite closely with the percentages of such grantees in our sample. However, the distribution of grantees over the limit according to OHDS regional location was not proportional to numbers of sample grantees from each region. Regions II and IV were somewhat overrepresented in that 72 percent of grantees over the limit came from these regions, whereas their grantees comprised only 47 percent of our sample. By contrast, Regions VI and VII, particularly Region VII, were underrepresented in grantees over the limit. There does appear to be a correlation between a lower number of grantees reported over the limit in these regions and the somewhat more thorough and systematic reviews of administrative cost levels noted in these two regions during our inspection.

A review of grantees equalling or exceeding the limit according to funding level shows a concentration of excessive administrative cost rates among smaller sized grantees. For example, 10 grantees or 40 percent had total budgets of \$500,000 or less and 10 grantees, and another 40 percent, had total budgets ranging from \$500,000 to \$1 million. While grantees of this size comprised about 60 percent of our sample they constitute 80 percent of total grantees over or equal to the limit during the three year period. Stated differently, 34.5% or about 1 of every 3

grantees below \$500,000 in our sample equalled or exceeded the limit. Likewise, among very large grantees, those with budgets ranging from \$3 to 5 million, three of six, or half of the sample grantees, exceeded the limit.

The above indicates a sizable number of grantees may merit increased management attention to assure their compliance with the 15 percent statutory limit.

b. Other Data Sources On Administrative Cost Limit Compliance

Head Start Cost Management Instrument

The HSCMI system, which called for a fairly rigorous breakdown of grantee administrative and program costs, typically showed higher administrative cost percentages than grantees and regional OHDS staff report. For example, in 1984, 73 of the grantees included in our sample had the HSCMI reviews. Of these 73 grantees, a total of 18 or 25 percent were found to exceed the 15 percent administrative cost limit. By contrast, only 10 sample grantees reported they had exceeded the limit in 1984, and OHDS staff in our sample regions reported only 5 grantees were over the limit during that year. OHDS staff in Regions II, IV and X say these substantial differences are largely accounted for by the fact that initial inputs of HSCMI administrative cost data were usually not adjusted to reflect regional office corrective actions to adjust administrative costs downward to acceptable levels.

c. Regional Staff Views On Grantees More Apt To Exceed The 15 Percent Administrative Cost Limit

Eight of ten regional OHDS offices believe certain types of grantees are more likely to have problems in complying with the 15 percent administrative cost limit than others. Among the commonly listed "problem" grantees are small budget grantees; local government and school grantees; large multi-layered or multiple delegate agency grantees; and grantees with "high" indirect cost rates who bill the full amount authorized by their approved rates.

Small agencies reportedly have more problems due to the limited funding base over which they must spread a minimum essential core of administrative services. Local governments and school districts contend they sometimes have difficulties due to their high salaries, tenured staff or excessive administrative overhead. Administrative costs also mount up very quickly for very large multilayered agencies or multiple delegate agency grantees. Finally, those agencies whose funding base is being eroded through loss of programs or reduced budgets are also more liable to have difficulty staying under the administrative cost limit.

C. OHDS ADMINISTRATIVE COST POLICY

1. Is The Statutory Provision Limiting Administrative Costs To 15 Percent Fair And Reasonable?

A majority of respondents, including 74 percent of grantees and 69 percent of Head Start directors, state that the statutory provision limiting administrative costs to 15 percent of total Program costs is generally fair and reasonable. Seventy-one (71) percent of grantees with direct costs only and 81 percent of grantees with indirect cost rates responded that the administrative cost limit is fair and reasonable.

As shown by the following, administrative costs are higher for grantees stating that the 15 percent limit is not fair and reasonable.

Limit Fair and Reasonable	Years/Administrative Cost Percentage		
	1983	1984	1985
YES	10.14%	10.23%	10.28%
NO	11.38	13.37	12.65

The main reason why some grantees and Program directors think the administrative cost limit is not fair and reasonable is that grant funding awards have not kept pace with increased program administrative costs.

2. Should The Head Start Administrative Cost Limit Be Varied Based On Grantee Total Funding?

Though a majority of grantees generally consider the 15 percent administrative cost limit as fair and reasonable, many state that the limit should perhaps be varied based on grantee total funding. Five of the ten regional OHDS offices also expressed this opinion.

Respondents	Administrative Cost Limit Should Be Varied
113 Grantees	62%
67 Head Start Directors	37%
10 Regional OHDS Offices	50%

Reasons for preferring an administrative cost limit that varies based on grantee total funding are as follows:

- ° Single purpose agencies, unlike multipurpose agencies, have no other funding sources to which they can charge the basic core of administrative services.
- ° Small grantees need more administrative dollars to obtain qualified staff and to cover core administrative services.
- ° Larger programs need larger staff to operate efficiently.

Data received from Head Start grantees suggests there is a fairly consistent inverse relationship between grantee total budget and average administrative cost percentages. For example, average administrative cost percentages are highest for grantees with the smallest budgets, declining steadily from the \$500,000 and under level through the \$3 million level. Administrative cost percentages appear to rise again for the large, multilayered grantees with budgets totalling more than \$3 million. This pattern is consistent with feedback from regional OHDS personnel concerning grantees most apt to have problems complying with the administrative cost limit, and with grantee reported statistics on exceeding the limit (see Attachment 5).

As OHDS develops more complete and accurate administrative cost data on its grantee population it might be advisable to assess the cost-effectiveness and appropriateness of employing administrative cost limits that vary by grantee funding level.

3. Is OHDS Policy Governing Head Start Grantee Administrative Costs Sufficiently Clear?

The extent to which the OHDS policy governing administrative costs is clear, explicit and uniformly interpreted by grantees and regional OHDS staff varies considerably, depending on the respondent. For example:

Policy Clear And Explicit?

While 40 percent of the OHDS staff contacted stated that such policy is not clear and explicit, only 12 percent of the responding grantees agreed.

Policy Uniformly Interpreted By Grantees And Regional OHDS Staff?

Respondents	Percentage Indicating Policy Not Uniformly Interpreted	
	By Grantee	By OHDS Staff
109 Grantees	13%	---
20 Regional OHDS Staff	65%	25%
10 Regional OHDS Offices	40%	---

ACYF Information Memorandum 83-9, dated April 11, 1983 includes examples of costs that may be considered administrative. Certain costs may benefit both direct program as well as administrative functions (e.g., the salary and benefits of a Head Start director who performs both program and administrative functions).

That OHDS policy does not specifically indicate what percentage of certain costs should be administrative or programmatic is cited as the main reason for administrative cost policy not being uniformly interpreted by grantees and regional OHDS staff (e.g., some regional OHDS offices may

classify the salaries and benefits of certain grantee staff [Head Start director] as 100 percent administrative, yet grantees may classify the same cost as 60 percent programmatic and 40 percent administrative).

RECOMMENDATION

1. OHDS should examine its administrative cost policy in ACYF Information Memorandum 83-9 with a view to providing more explicit standards and examples of administrative costs that will: (1) promote a more consistent definition of these costs by grantee and regional office staff, and (2) assure more uniform interpretation and enforcement of this policy. To provide a more firm basis for regional office enforcement, this clarified policy standard should be issued via regulations, rather than as an information memorandum.

D. STATUS OF OHDS CONTROLS ON GRANTEE ADMINISTRATIVE COSTS

Head Start enabling legislation and pertinent regulations prohibit the expenditure of more than 15 percent of the total approved grantee budget for the costs of developing and administering a Head Start program.

1. Responsibilities And Methods For Verifying Compliance With The Administrative Cost Limit

Officials at eight of the ten regional OHDS offices state that responsibility for ensuring Head Start grantee compliance with the 15 percent administrative cost limit is shared by both Office of Financial Operations (OFO) and Head Start program officials. At the other two regions program officials are viewed as having total responsibility for this function.

Verifying compliance with the developmental and administrative cost limit has been accomplished by several methods: verifying that the grantee submits a signed certification that these costs do not exceed 15 percent of the total budget; performing a cost analysis of the grantee's budget at time of funding; and/or completion of the HSCMI.

a. Certification Of Head Start Administrative Costs

A certification that developmental and administrative costs for a program year will not exceed 15 percent of the total budget is to be signed by an official from the grantee and submitted with each budget proposal. This certification also states that documents to substantiate these costs are available in the grantee's files for review by auditor and OHDS/HHS personnel.

b. Budget Analysis

Regional OHDS grants management staff, in coordination with Head Start program officials, are responsible for performing a cost analysis of Head Start grant awards prior to funding to determine the necessity, reasonableness and allocability of the costs reflected in the grantees' budgets.

c. Head Start Cost Management Instrument

In recent years OHDS began developing a cost management instrument, the HSCMI, designed to provide additional information on grantee program and administrative cost factors. As it pertains to administrative costs, the HSCMI requires that detailed administrative cost data be provided by the grantee. Regional OHDS staff generally agree that this instrument adequately breaks out administrative costs and, therefore, provides an effective means for monitoring of these costs.

The HSCMI is, as a rule, to be completed every three years for each grantee. OAI found that the HSCMI, in six OHDS regions was being completed by ACYF; in two regions by ACYF and OFO jointly; and in two regions by the grantees. In most instances the instrument was completed after telephone and/or written communication between the regional offices and the grantees.

Subsequent to the start of this inspection, OHDS submitted the HSCMI to the Office of Management and Budget (OMB) for approval as a public use document.

The HSCMI was not approved as a public use document. As a result, OHDS cannot request grantees to complete the HSCMI themselves, nor can grantees be requested to prepare data so that OHDS staff can complete the instrument. The only permitted use is for Head Start staff to extract data during on-site visits to the grantee and to gather data from existing OHDS sources.

2. Need To Strengthen Analysis And Controls On Grantee Administrative Costs

Many regional OHDS staff state there are no requirements for grantees to submit detailed administrative cost data with their funding applications; that grantees' signed "certification" that such costs do not exceed the 15 percent cost limit is sufficient to satisfy OHDS requirements; that completion of the HSCMI required this detailed data be reviewed by OHDS staff; and that their years of experience in working with grantees is sufficient to alert them to problems in this area. As a result, cost analyses of Head Start grant applications do not generally involve a thorough, systematic review, nor do they determine the specific level of grantee administrative costs.

Regional OHDS Cost Analysis Efforts Are Weak

The thoroughness of review of administrative costs varies significantly from region to region. Grantee records are generally not documented with results of cost analysis. While the grantees' signed "certification" indicates that administrative costs do not exceed the 15 percent limit, it does not indicate the actual percentage and amount of such costs. Therefore, not only does OHDS not know the actual level of administrative costs, it is also unable to determine what such costs should be (i.e., are they necessary, reasonable [excessive] and allowable).

Some regions report that lack of time and staff prohibit them from conducting detailed cost analyses.

Need To Upgrade Regional Cost Analysis Efforts

Chapter 15 of the OHDS Grants Administration Manual states, in part, that grants management staff, in coordination with program office officials, are responsible for performing a cost analysis of Head Start funding applications prior to funding to assure that grantee costs are necessary, reasonable and allowable. The extent of a cost analysis will vary among projects and shall be determined on the basis of the amount and types of costs involved, the nature of the project and past experience with the grantee. A cost analysis may consist of an arithmetic verification to assure that computations are correct, a review to assure that costs identified are allowable, and, if applicable, a determination of the consistency of charges between direct and indirect costs, as well as the application of the proper indirect cost rate.

P.L. 97-35, Section 644(b) states, in part, that in any case in which it is determined that the costs of administering a Head Start program does not exceed 15 percent of such total costs but is excessive, the grantee shall be required to take such steps prescribed by OHDS as will eliminate such excessive administrative costs.

Need For Detailed Administrative Cost Data

Each regional OHDS office, at its own discretion, may require detailed administrative cost data from Head Start grantees. At ten regional OHDS offices:

- ° One does request grantees to submit detailed administrative cost data with their applications.
- ° One requires grantees to place an asterisk by those costs considered by the grantee to be administrative.
- ° One required such detailed cost data only if it appeared that the 15 percent limit would be exceeded; however, beginning with FY 86 budget, grantees will be requested to submit such detailed data with each grant proposal.

- ° One, beginning with FY 86 budgets, has begun to review these administrative costs in greater detail, by having developed a form on which OFO will list the administrative costs after reviewing the grantee's application.
- ° Six do not request grantees to submit detailed administrative cost data with their applications.

Of 20 (8 OFO; 12 ACYF) regional OHDS staff interviewed at four regional OHDS offices, 11 stated that detailed administrative cost data should be required with all grantee applications; 4 stated that it should not be a requirement because of differences between regional office and grantees in the interpretation of what is/is not an administrative cost, and because this data could be obtained upon completion of the HSCMI every 3 years; and 1 stated that it would not be possible to get this information because the grantees themselves cannot determine what is/is not an administrative cost.

There are no OHDS grant application guidelines that require grantees to submit detailed administrative cost data with their funding applications. However, such requirement is implied by both the OHDS Grants Administration Manual and P.L. 97-35, if a grantee's level of such costs is to be determined necessary, reasonable and allowable.

OHDS Should Reexamine Its Intended Usage Of The HSCMI

Although OMB has not approved the HSCMI as a public use document, Regional OHDS staff generally regard this instrument as a good tool for measuring overall grantee costs. Many of them state that completion of the HSCMI will provide the necessary breakdown of cost data to determine the level of administrative costs. Some state that annual completion of this instrument would take care of problems in this area. However, ACYF staff who have responsibility for all aspects of the HSCMI preparation and input into the national data base have cited the following problems:

- ° Data entry is a long tedious process due to the number of entries required and the frequent poor system response time. A single HSCMI may take from 2 to 6 hours to input.

- ° Staff shortages make it difficult to handle the current HSCMI data input requirements.
- ° Annual preparation might result in diminishing returns, in that this staff feels most grantees' budgets do not change very much from year to year.

Another problem now facing OHDS is that grantees can no longer be requested to complete the HSCMI, nor can grantees be requested to prepare data so that OHDS staff can complete the instrument. As previously stated, the only permitted use is for Head Start staff to extract data during on-site visits to the grantee and to gather data from existing OHDS sources.

While many regional OHDS staff state that their years of experience in working with grantees will alert them to any problem(s) in this area, not only is the yearly level of administrative costs not known, but it is also not known if this level is excessive. Also, in the event of staff turnover, the new staff member(s) may lack experience in working with grantees.

RECOMMENDATIONS

1. OHDS should change the self-certification form to require grantees to show the projected total amount of administrative costs the grantee expects to incur in running the program, not only that administrative costs are under 15 percent of total budget.
2. OHDS should require selected grantees (i.e., those whose administrative costs exceed, equal or closely approximate the statutory administrative cost limit) to submit a detailed breakdown of administrative costs with their funding applications. OHDS should secure the necessary ASMB and OMB clearances to institute systematic reporting of additional administrative cost data, on an exception basis, for these grantees.
3. Regional OHDS staff should utilize this data in analyzing the amount and appropriateness of administrative costs. These cost analyses reviews should carefully and clearly document and control the portion of time allocated to administrative and programmatic activities by all key grantee staff from year to year.

4. Cost analysis findings should be systematically documented in grantee files each year to establish a baseline for monitoring. Regional OHDS staff should accumulate summary records on administrative costs for ongoing monitoring and management needs.
5. For grantees with indirect cost rates, regional OHDS staff should check to avoid duplicate billing of costs as both direct and indirect by reviewing the makeup of the indirect cost pool against other administrative costs items.
6. In light of OMB not approving the HSCMI as a public use document, OHDS should examine the HSCMI to determine if this instrument can be utilized by its staff to stay abreast of administrative costs. If OHDS determines that the HSCMI can be utilized, it should:
 - ° Review the feasibility of completing this instrument, at least the administrative costs section, on an yearly basis for each grantee.
 - ° Assure that regional grants management staff responsible for cost analysis of grantee budgets routinely consult the last HSCMI findings on administrative costs during their cost analysis activities.
 - ° Make the necessary systems adjustments that would reduce the two to six hour system response time when HSCMI data input occurs.
3. Independent Auditors Do Not Examine Grantee Compliance With The 15 Percent Administrative Cost Limit

P.L. 97-35, Sections 647(a) and (b), state, in part, that recipients of financial assistance shall keep such records as will facilitate an effective audit; and that the Secretary or any of his duly authorized representatives shall have access for the purpose of audit and examination to any books, documents, papers and records of the recipients that are pertinent to the financial assistance received.

Head Start program regulations at 45 CFR 1301.12(a), state, in part, that an audit of the Head Start program covering the prior budget period of each Head Start grantee and its delegate agencies, if any, shall be made by an independent auditor to determine: (1) whether the grantee's financial statements are accurate; (2) whether the grantee is complying with the terms and conditions of the grant; and (3) whether appropriate financial and administrative procedures and controls have been installed and are operating effectively. No distinction is made between State and local government and nonprofit grantees.

The Single Audit Act of 1984 requires State and local government grantees participating in the Head Start program to obtain independent organization-wide audits of their operations. OMB Circular A-128 was issued pursuant to this Act and established audit requirements for these grantees.

Departmental Regulations at 45 CFR Part 74, state that recipients that are governments shall comply with requirements concerning nonfederal audits in OMB Circular A-128; and recipients that are not governments shall comply with the requirements in OMB Circular A-110.

OMB Circular A-110 requires all other Head Start program grantees to obtain nonfederal institution-wide audits in lieu of individual program audits. The Assistant Secretary for Management and Budget (ASMB) and the OIG/OA indicate that some confusion may exist among Head Start grantees as a result of conflicts between this OMB Circular and Head Start program audit requirements.

Per ASMB and OIG/OA, grantees that are not governments are to be audited following Circular A-110 guidelines. Therefore, OHDS is out of compliance with departmental regulations by requiring, per 45 CFR 1301.2(a), audits of Head Start programs using the Head Start Audit Guide. Per OHDS, until audit guidelines similar to those delineated in Circular A-128 are issued for grantees that are not governments, it may continue to require audits of nongovernment Head Start programs using the Head Start Audit Guide. However, if a nongovernment grantee requests an organization-wide audit, OHDS will comply with the request and accept the results of the audit.

ASMB and OIG/OA recognize that the issue of whether grantees that are not governments are to be audited following Circular A-110 or 45 CFR 1301.2(a) requirements may not be totally resolved until the issuance of a revised OMB Circular A-110, but they view the existing Head Start regulation as particularly misleading to these grantees. ASMB and OIG/OA feel that OHDS must take some interim immediate action to resolve confusion among the Head Start grantee community.

Compliance review guidelines for grantees that are not governments do not exist. Guidelines established by Circular A-128 are used when performing audits under Circular A-110. However, these review guidelines do not include review of the 15 percent administrative cost limit. In addition, none of the audit standards currently being used by independent auditors when auditing Head Start grantees mention review of grantee records to determine compliance with the 15 percent administrative cost limit.

At four regional OHDS offices, OAI reviewed independent audit reports on 16 Head Start grantees and did not find any evidence that Program independent audits address grantee compliance with the 15 percent administrative cost limit.

Among regional OHDS offices there is a definite difference of opinion as to whether the annual Program audit should specifically review compliance with the 15 percent limit: five regions stated that the limit should be addressed; four regions stated that it should not; and one region stated yes (OFO) and no (Programs).

Reasons for "Yes" Responses:

- (1) 15 percent limit is a statutory requirement and should be reviewed.
- (2) Most cost effective way for OHDS to monitor this area yearly.
- (3) Provides actual, rather than budgeted, costs.

Reasons for "No" Responses:

- (1) Will result in excess Head Start program audit costs.
- (2) There is usually not a clear audit trail of costs, as grantee financial records do not always break out this information.
- (3) Audit period would not always be the same as the program year.
- (4) Won't matter if go to "single audit" (i.e., audit encompassing all grantee programs).

Per the Single Audit Act and OMB Circular A-128, to the extent that the organization-wide audit provides OHDS with information and assurances needed to carry out its overall responsibilities, it shall rely upon and use such information. However, OHDS can request any additional audits which are necessary to carry out its responsibilities under Federal law and regulations. Such additional audits can include economy and efficiency audits, program result audits, and program evaluations. Any additional audit effort shall be planned and carried out in such a way as to avoid duplication of the organization-wide audit, and OHDS shall arrange for funding the cost of any additional audit.

RECOMMENDATIONS

1. OHDS, in consultation with ASMB, should revise its program regulations to conform to departmental audit policy and notify all Head Start grantees of the Department's audit requirements.
2. OHDS should develop compliance review guidelines that will address grantee compliance with the 15 percent administrative cost limit when grantees are audited under OMB Circulars A-128 and A-110. OHDS should request OIG/OA assistance in developing these guidelines. These guidelines should be based upon a more explicit and consistent definition of administrative costs as issued in OHDS regulations, as recommended on page 14.
3. OHDS should request, for grantees affected by the Single Audit Act and for grantees exceeding or determined to be at risk of exceeding the 15 percent administrative cost limit, any additional audits which are necessary to carry out its responsibilities to enforce the statutory limit on administrative costs. Before requesting any additional audits, OHDS should coordinate with OIG/OA to determine the most feasible way to obtain the audits and to assure that no functions of the organization-wide audit will be duplicated.
4. How Do Regional OHDS Staff Handle Problems With Grantees Exceeding The Administrative Cost Limit?

Sparing Use of Waiver Authority

OHDS policy (ACYF-IM-83-9) authorizes Head Start officials to grant waivers of up to 12 months duration to cover situations where grantees expect

to exceed the administrative cost limit. However, regional questionnaires indicate only very sparing use of this authority. Over the 3-year study period only 16 waivers were requested, with 14 granted. Half of these requests and approvals were from Region III. In 1985 only three waivers were requested and granted, 1 each in Regions III, V and X. It appears that most regions prefer negotiations or corrective action to reduce potentially excessive administrative costs rather than waivers authorizing them.

No Disallowances Of Excessive Administrative Costs

OHDS policy also specifies that when excessive actual administrative costs are discovered by audit or financial review "the excessive administrative costs shall be disallowed". During 1983, 1984 and 1985 none of the 10 OHDS regions reported ever disallowing administrative costs over the 15 percent limit when such costs were detected subsequent to funding awards through audits or financial reviews. This is not surprising in view of the fact that regions report audits rarely, if ever, address administrative cost compliance.

Prefunding Negotiation - The Method Regions Prefer

Prefunding negotiation between the regional OHDS staff and grantee is the preferred method for dealing with administrative costs known or expected to exceed the 15 percent limit. Regions try to get agreement on what costs are administrative and then seek voluntary grantee compliance on corrective actions or target areas to reduce. Regions report a wide variety of means may be used to reduce overall administrative costs including:

- ° Reorganizing and eliminating or combining staff positions.
- ° Revising position descriptions.
- ° Revising or reallocating staff hours expended on program versus administrative functions.
- ° Increasing grantee nonfederal share contributions to expand the base for computing the 15 percent limit.
- ° Disallowing indirect costs billed whenever full payment would push the grantee over the statutory 15 percent limit.

Doubtless, such "front-end" controls help hold down administrative costs. However, the extent to which such prefunding adjustments of budgeted or projected administrative costs result in real decreases in actual administrative costs, rather than mere bookkeeping or paper changes, can only be verified by audits of actual costs. Unfortunately, this rarely occurs.

E. INDIRECT COSTS

OMB Circular A-122 "Cost Principles for Nonprofit Organizations" and other OMB circulars govern the definition of indirect costs and the calculation of indirect cost rates for Head Start grantees.

Indirect costs are those costs which cannot be specifically identified with a particular project or program but are nevertheless necessary to the operation of an organization and the performance of its programs. The cost of operating and maintaining facilities, equipment and grounds; depreciation or use allowances; administrative salaries and supplies are typical examples of the type of costs which are usually considered as indirect costs at nonprofit organizations.

In theory, these types of costs might be charged directly. However, this approach is usually impractical for many grantees. These costs, therefore, are grouped into a common pool and distributed to benefiting activities by a cost allocation process. The end product of this allocation process is an indirect cost rate which is applied to individual projects supported by grants, contracts and other agreements with the Federal Government to determine the amount of indirect costs applicable to each project.

The indirect cost rate is a ratio, expressed as a percentage, of the indirect costs to a direct cost base. The direct cost base is usually either total direct cost (not including capital expenditures and other distorting items) or direct salaries and wages. The base selected must produce an equitable distribution of indirect costs. These costs are reimbursed based on a cost rate, subject to statutory or administrative limitations, as part of the total cost of individual awards.

Indirect cost rates are established by agreement between the organization and a cognizant Federal agency that acts on behalf of all Federal agencies in approving rates with the organization. With limited exceptions, the Division of Cost Allocation (DCA) in the Regional Administrative Support Center is responsible for approving indirect cost rates for all HHS grants and contracts.

Obtaining An Indirect Cost Rate

All grantees desiring reimbursement of indirect costs must have a negotiated indirect cost rate. The grantee, to obtain an approved rate, will submit an indirect cost rate proposal to the DCA. Along with the proposal, the grantee submits financial information and statements (usually in the form of consolidated financial statements or independent audits) to substantiate its request for the rate. The proposal and financial information is then reviewed in accordance with regulations.

The DCA will ascertain that only allowable costs are included in the indirect cost pool for reimbursement; that the indirect cost allocation procedures fairly distribute the costs among all of the grantees' programs; and that there is no duplicate billing of services (i.e., billing for a service as both a direct and indirect cost). After all required actions are completed, the DCA advises the grantee of the indirect cost rate to be used. The approved rates are formalized by a Negotiation Agreement which reflects the rates and information directly related to the use of the rates (e.g., effective dates, base, etc.). The Negotiation Agreements are published as part of an overall Departmental system and are to be distributed to all awarding agencies.

Grantees have obtained indirect cost rates primarily for the following reasons:

- ° administrative cost reimbursement through direct charges was inadequate;
- ° regional OHDS officials required or encouraged this;
- ° regional DCA officials encouraged this;

- ° State Community Service Block Grant officials required this; or
- ° other grantee administered programs required this.

1. Regional OHDS Offices Generally Neither Encourage Nor Discourage Grantee Indirect Cost Rates

Of the ten regional OHDS offices contacted.

- ° Seven neither encourage nor discourage grantee indirect cost rates.
- ° One discourages grantees from obtaining indirect cost rates because "direct costing provides a better picture of administrative costs and allows for more effective OHDS monitoring of such costs."
- ° Two encourage grantees to obtain indirect cost rates, one because of "DHHS Grants Administrative Policy," the other because it is a fair method of determining a program's fair share of grantee costs.

2. Problems Encountered With Indirect Cost Rates Approved By The DCA

Regional OHDS Offices Are Sometimes Not Consulted In Establishing Indirect Cost Rates

Departmental guidance from the Office of Procurement and Assistance Financial Management, dated June 30, 1982 was sent to all the DCAs wherein they were directed to provide copies of indirect cost proposals from multiple-purpose Head Start grantees to the OHDS staff for their review and comment prior to the negotiation and approval of the grantees' indirect cost rates. On July 20, 1983 this guidance was followed by another memorandum to the DCAs requiring them to note on the Negotiation Agreements the specific components of the indirect cost pool. This was done so that OHDS staff, when reviewing grant applications, would be aware of what costs were treated as indirect so they could ensure that the same costs were not proposed, and approved, as direct costs in

the grant award. This information was to be provided to aid OHDS staff in reviewing grantee compliance with the 15 percent administrative cost limitation. Despite this guidance, so long as grantee proposals complied with OMB guidelines, a few regional DCA offices were not convinced of the benefit of or need for involving OHDS in any facet of approving indirect cost rates.

DCA offices in seven regions usually consult with OHDS staff prior to approving an indirect cost rate. This consultation may include: (1) advising OHDS staff that a grantee rate proposal has been received; (2) providing OHDS staff with a copy of the proposal for review (e.g., ascertaining that there is no duplicate billing, and reviewing the necessity of such costs); and (3) requesting OHDS comments based on the review or on staff's knowledge of a grantee's operation.

Though no action(s) may result from their review, OHDS offices in these regions state that they at least stay abreast of those grantees that obtain indirect cost rates, and if questions concerning indirect costs arise, they are able to readily respond to them.

DCA respondents at the other three regions state they do not advise OHDS staff of grantee requests for indirect cost rates because: (1) there is no requirement to do so, and (2) they used to advise and/or provide copies of the requests, but stopped after never receiving any comments.

Other OHDS Indirect Cost Rate Concerns

At four regional OHDS offices, over one-half of the staff interviewed reported other problems with the indirect cost rates approved by the DCA:

- ° Five believe rates are too high at times and, therefore, cause some grantees to exceed the 15 percent administrative cost limit.
- ° Three state that potential for duplicate billing exists (i.e., billing certain costs as both direct and indirect).

- ° Two are not sure how the indirect cost rate is calculated.
- ° One states that the Program does not receive a commensurate level of administrative services for the amount paid.

Head Start Program Directors' Concerns With Indirect Cost Rates

Program directors interviewed in grantees having indirect cost rates, expressed several concerns with the indirect costs charged by grantees:

- ° Three state that the Program does not receive a commensurate level of administrative services for the amount paid.
- ° Two state that the Program was charged more than what was budgeted for administrative costs.
- ° Two state that directors are not involved in the establishment of the indirect cost rate.
- ° One states that Policy Board members do not understand the effects of obtaining an indirect cost rate.

RECOMMENDATION

Regional OHDS offices should be actively involved in the review of indirect cost rates, including obtaining copies of indirect cost rate proposals from the DCA; reviewing these proposals and being able to communicate any findings to the DCA for appropriate action; and receiving copies of the final approved indirect cost rates.

3. Statutory Administrative Cost Limit Sometimes Prevents Full Reimbursement Of Indirect Costs

Some programs, including Head Start, have limits on the amount they will pay for administrative and indirect costs. The result is that the grantee is often unable to recoup the full amount of indirect costs due from the programs it administers.

Of the ten regional OHDS offices contacted, seven stated they will reduce reimbursement of grantee indirect costs if full payment will cause total administrative costs to exceed the 15 percent administrative cost limit.

OMB circulars and OHDS policy clearly allow Head Start grantees to obtain indirect cost rates and to bill the Program for indirect costs. Nevertheless, because of the statutory administrative cost limit, OHDS does not fully reimburse indirect costs when adding them to other grantee administrative costs would result in the grantee exceeding the 15 percent limit. In other words, indirect costs billed are used as a final adjusting item to hold grantees under the 15 percent limit.

RECOMMENDATION

OHDS should issue a policy notification to grantees apprising them that this practice will be commonly used to reconcile conflicts between these two policy provisions.

4. Grantee Indirect Cost Rates Fairly Distribute The Cost Burden Among All Funding Sources

While some programs place a limit on the amount they will pay for indirect costs, a majority of respondents (regional OHDS offices, grantees and Head Start directors) stated that the indirect cost rate chosen fairly distributes the cost burden among all of the grantees' funding sources. For example:

- ° Seven of ten regional OHDS offices stated that the Program does pay its fair share of indirect costs; one stated that in only one instance did it feel Program was paying a disproportionate share of such costs; and two stated that they did not know.
- ° Seventy-three (73) and 65 percent of the grantees and Head Start directors, respectively, stated that the indirect cost rate chosen fairly distributed the cost burden among all grantee funding sources.

F. NONFEDERAL SHARE CONTRIBUTIONS

Financial assistance for a Head Start program is comprised of Federal and nonfederal share (NFS) contributions. Federal financial assistance shall not exceed 80 percent of the program's approved costs. NFS contributions, which may be in cash or in kind, fairly evaluated, including plant, equipment or services, are to make up the remaining 20 percent of the program's

budget. The grantee shall not be required to obtain NFS contributions in excess of 20 percent of the program's approved costs. However, the grantee is not prohibited from obtaining such contributions in excess of 20 percent.

1. Nonfederal Share Contributions In Excess Of
Twenty Percent Included In Grantee Total Budget

In 1983, 1984 and 1985, 51, 62, and 55 percent of the grantees, respectively, reported that they received NFS contributions in excess of 20 percent. Of those, 39 percent stated that all NFS contributions were included in the total budget against which their 15 percent administrative cost limit was computed.

Seven of ten regional OHDS offices stated they allow grantees to include all NFS contributions in their total budgets against which the administrative cost limit is computed. One region states that it allows grantees to include all NFS contributions in their total budgets only under special circumstances (i.e., if a grantee's administrative costs will exceed the 15 percent limit, and after all other alternatives to lower the limit have been explored).

Allowing grantees to include NFS contributions in excess of 20 percent of their total budgets, when computing their administrative cost limit, may result in the following:

- ° Allows the administrative cost percentage to remain below the 15 percent limit (e.g., a grantee's administrative cost percentage is reported as 13.6 percent if NFS contributions of 37 percent are allowed. However, if NFS contributions are limited to 20 percent, its administrative cost rate would exceed the limit at 18.1 percent).
- ° Increases the amounts of funds that can be utilized by grantees for administrative services (e.g., a grantee receiving a Federal grant of \$800,000 can match it with \$160,000 of NFS contributions and therefore, be entitled to at most \$144,000 [$\$960,000 \times 15$ percent] of

administrative spending. However, if the grantee includes \$300,000 of NFS contributions in its proposed budget, the funds available for administrative spending increases to \$165,000).

- If nonfederal contributions consist mostly of items that require substantial amounts of a grantee's administrative resources to manage, the grantee's administrative cost percentage might exceed the 15 percent limit (e.g., if NFS contributions are mostly volunteers, the costs of recruiting, training, etc., might actually cause the grantee to exceed the 15 percent limit).

The number of grantees that would exceed the 15 percent administrative cost limit if their NFS contributions were held to 20 percent of their total budgets are as follows:

Year	Total No. Grantees	No. Grantees That Would Exceed Limit	Percentage
1983	95	7	7.37%
1984	101	6	5.94%
1985	105	5	4.76%

The increased amounts of funds utilized by sample grantees for administrative services as a result of being able to include all NFS contributions in excess of 20 percent of their total budgets totalled \$258,028 from 1983 through 1985:

Year	Number Grantees	Amounts Per Year
1983	7	\$ 57,336
1984	8	90,071
1985	10	110,621
Totals	25	\$258,028

RECOMMENDATION

OHDS should conduct further study to determine whether or not NFS contributions in excess of 20 percent should be included in the total grantee budget against which the 15 percent limit is computed. Until such a determination is made, OHDS needs to assure consistency among all regional offices on how NFS contributions in excess of 20 percent of the grantees' total budgets are handled.

G. BENEFITS TO HEAD START PROGRAM OF ADMINISTRATIVE SERVICES RECEIVED FROM GRANTEEES

Of 67 Head Start program directors interviewed, 54, or 81 percent, stated the Program is receiving adequate administrative service benefits from grantees; 9, or 13 percent, stated the Program is subsidizing unnecessary or unreasonably high grantee administrative costs; and 4, or 6 percent, did not know whether or not the Program is receiving sufficient administrative services from grantees.

Directors stating that the Program is subsidizing unnecessary or unreasonably high grantee administrative costs cite the following examples:

- ° Five state that the problem stems from indirect cost rates being too high.
- ° Two state Program dollars are used to pay other grantee programs' bills.
- ° One states that the Program receives no services from the grantee.
- ° One states it is only a "feeling."

Indirect Cost Grantees

Almost half of the interviewed Program directors, in grantees with indirect cost rates, do not think the grantee administrative services they receive are worth the indirect costs charged to the Program. However, only two directors were willing to state that either the Program was paying for services not received or for services its employees were already performing. Eight directors provided no explanation for their opinion that the Program was not receiving a commensurate level of services. (Note: One director stated that he knew of other directors being fired for questioning the amount of services received/not received from the grantee; another director wanted to find out who would be reading our report before he answered certain questions, presumably because of fear of losing his job.)

Some directors who think the Program does receive a commensurate level of administrative services from the grantee gave the following reasons why other directors perceive deficiencies in grantee services:

- ° Lack of communication between the grantee and the Program director as to what services would/would not be provided.
- ° The director's lack of understanding of which indirect costs are legitimate.
- ° Lack of involvement by the director and/or Policy Council in development of indirect cost rates (e.g., not wishing to be involved or not rightfully demanding to be involved based on the Program's size and significance).

Eight of 20 regional OHDS staff respondents believe grantee indirect cost charges are not justified by the level of administrative support Head Start receives. Three of them stated, respectively, that the Program can perform administrative services more cost-effectively than grantees; that the Program has been able to provide its own administrative services without grantee assistance; and, even with indirect cost rates, the grantee is still not rendering any administrative services to the Program. The other five provided no explanation for their opinion. Most regional staff were not able to assess the benefits associated with indirect charges.

It is interesting to note that OHDS staff stating the Program does not receive commensurate services from the grantee were from two of seven regional OHDS offices that said the Program is paying its fair share of the grantee's indirect cost rate.

H. FUTURE COMPLIANCE WITH ADMINISTRATIVE COST LIMIT

Grantee Compliance With The 15 Percent Administrative Cost Limit May Become More Difficult In The Future

The extent to which compliance problems are foreseen varies considerably, depending on the respondent. For example:

Respondents	Percentage Indicating Future Grantee Compliance Problems
115 Grantees	23%
67 Head Start Directors	60%
20 Regional OHDS Staff	65%
10 Regional OHDS Office	70%

The main reasons why Head Start grantees are expected to have difficulty complying with the 15 percent administrative cost limit are as follows:

Reason	Respondents	Percentage*
1. Increases in administrative costs with no commensurate increases in grantee budgets.	Grantees	54%
	Head Start Directors	28%
	OHDS Staff	15%
2. Budget cuts - "Gramm-Rudman-Hollings".	Head Start Directors	55%
	OHDS Staff	69%
3. Other funding sources decreasing or stopping funding.	Grantees	15%
	OHDS Regional Offices	71%

* Percentages based on respondents indicating grantee problems in complying with the administrative cost limit.

Increases in administrative costs stem from rising costs for insurance, administrative salaries and fringe benefits, utilities, transportation, etc.

Some grantees have mandatory increases due to State laws. For example, at some school districts, specifically those functioning as Head Start grantees or delegate agencies, State law may provide that any person working for the school system is entitled to all benefits received by all school employees. Thus, a 17 percent raise for school employees means a similar raise for Head Start employees affiliated with the school district.

The Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177, commonly known as Gramm-Rudman-Hollings) resulted in a 1.4 percent reduction in Head Start grantee budgets for fiscal year 1986. Also, some grantees that receive additional funding from other sources have been advised by these sources that funding may be decreased or stopped.

V. SUMMARY OF COMMENTS

OHDS

OHDS stated the OAI inspection is thorough and identifies key issues related to the monitoring and control of administrative costs in the Head Start program. However, OHDS did not specifically comment on the inspection's recommendations, but limited its comments to technical aspects of the report and the methodology used to obtain the findings.

OAI and OHDS met to resolve and incorporate revisions, as appropriate, for all technical and clarification questions raised. Conveying its general support for the thrust and content of the report's recommendations, OHDS asked OAI to strengthen some of the recommendations. OHDS noted general consistency between the report's recommendations and its in-process or planned activities to address most of the problems raised by the OAI inspection.

ASMB

ASMB had two substantive comments affecting OAI findings and recommendations:

- (1) All references to the Head Start Cost Management Instrument (HSCMI) need to be updated to reflect OMB action. OMB disapproved the instrument as a public use document. The only permitted use is for Head Start staff to extract data onsite and to gather data from existing sources. It is illegal to request grantees to prepare the data so that Head Start staff can fill in the blanks.
- (2) Discussion on audit requirements is inaccurate:
(1) under OMB Circular A-110, nonprofit grantees are required to have organization-wide audits; and (2) the Single Audit Act limits the audit requirements that can be placed on governments. Therefore, the first recommendation must be revised, and the second must point out that Head Start's annual audit requirement has to be revoked.

Concerning ASMB's comments, OAI revised the report as follows:

- (1) References to the HSCMI reflect OMB disapproval of the instrument as a public use document.
- (2) OMB Circular A-110 requires all other Head Start program grantees to obtain nonfederal institution-wide audits in lieu of individual program audits. The Assistant Secretary for Management and Budget and the OIG/OA indicate that some confusion may exist among Head Start grantees as a result of conflicts between this OMB Circular and Head Start program audit requirements.
- (3) Per ASMB and OIG/OA, grantees that are not governments are to be audited following Circular A-110 guidelines. Therefore, OHDS is out of compliance with departmental regulations by requiring, per 45 CFR 1301.2(a), audits

of Head Start programs using the Head Start Audit Guide. Per OHDS, until audit guidelines similar to those delineated in Circular A-128 are issued for grantees that are not governments, it may continue to require audits of nongovernment Head Start programs using the Head Start Audit Guide. However, if a nongovernment grantee requests an organization-wide audit, OHDS will comply with the request and accept the results of the audit.

- (4) ASMB and OIG/OA recognize that the issue of whether grantees that are not governments are to be audited following Circular A-110 or 45 CFR 1301.2(a) requirements may not be totally resolved until the issuance of a revised OMB Circular A-110, but they view the existing Head Start regulation as particularly misleading to these grantees. ASMB and OIG/OA feel that OHDS must take some interim immediate action to resolve confusion among the Head Start grantee community.

ATTACHMENTS

Attachment 1 Profile of Grantee Sample

Attachment 2 Administrative Cost Percentage
by Grantee Type

Attachment 3 Administrative Cost Percentage
by Grantee and Cost Type

Attachment 4 Head Start Grantees Reported Equalling or
Exceeding Statutory Administrative
Cost Limit

- 4-A ... By Grantee Type
- 4-B ... By Type Cost
- 4-C ... By Region
- 4-D ... By Funding Level

Attachment 5 Head Start Grantees Administrative Cost
Percentages by Funding Level

PROFILE OF GRANTEE SAMPLE

National Head Start Grantee Population *			Regional Sample Grantees						
Grantee (Cost Type)	Number	Percentage	II	IV	VI	VII	X	Total	Percentage
<u>CAA</u>	910	75.9%	14	25	23	12	8	82	68.3%
(Indirect)	(207)		(-0-)	(17)	(4)	(8)	(2)	(31)	
(Direct)	(703)		(14)	(8)	(19)	(4)	(6)	(51)	
<u>Other Private Non Profit</u>	61	5.1%	3	5	1	2	4	15	12.5%
(Indirect)	(14)		(-0-)	(1)	(1)	(-0-)	(1)	(3)	
(Direct)	(47)		(3)	(4)	(-0-)	(2)	(3)	(12)	
<u>Schools Public and Private</u>	76	6.3%	-	4	2	1	2	9	7.5%
(Indirect)	(19)		-	(2)	(-0-)	(-0-)	(1)	(3)	
(Direct)	(57)		-	(2)	(2)	(1)	(1)	(6)	
<u>State and Local Gov't.</u>	87	7.3%	3	2	3	1	1	10	8.3%
(Indirect)	(21)		(-0-)	(-0-)	(-0-)	(-0-)	(1)	(1)	
(Direct)	(66)		(3)	(2)	(3)	(1)	(-0-)	(9)	
<u>Higher Education</u>	25	2.1%	-	1	1	1	1	4	3.3%
(Indirect)	(23)		-	(-0-)	(1)	(1)	(1)	(3)	
(Direct)	(2)		-	(1)	-	(-0-)	-	(1)	
<u>Other and Unknown</u>	40	3.3%	-	-	-	-	-	-	
(Indirect)	(-0-)		-	-	-	-	-	-	
(Direct)	(40)		-	-	-	-	-	-	
Totals	1199	100%	20	37	30	17	16	120	** 100%
(Indirect)	(284)	(23.7%)	(0)	(20)	(5)	(9)	(6)	(41)	(34.2%)
(Direct)	(915)	(76.3%)	(20)	(17)	(24)	(8)	(10)	(79)	(65.8%)

(* National Grantee Population from 1984 OHDS Grants Management Information System [GMIS] Report; * 99.9% rounded)

Administrative Cost Percentage by Grantee TypeGrantee Self-Report Data

Type Grantee	No.	1983		1984		1985	
		Percentage	Rank	Percentage	Rank	Percentage	Rank
CAA	81	10.1%	4	11.0%	4	10.8%	4
Local Government	10	13.8%	1	13.0%	2	13.1%	2
Other Private Non-Profit	14	12.1%	3	12.2%	3	11.9%	3
School	9	9.0%	5	8.3%	5	8.4%	5
University *	1	13.7%	2	13.9%	1	13.6%	1

(* Only One Grantee Included)

Administrative Cost Percentage by Grantee and Cost TypeGrantee Self-Report Data

Type Grantee	No. Grantees	Type Cost	1983	1984	1985
CAA	51	Direct	9.7 %	10.5 %	10.0 %
	30	Indirect	10.9	11.9	12.2
Local Governments	9	Direct	13.8 %	12.2 %	13.1 %
	1	Indirect	N/A	18.1	13.2
Other Private Non-Profit	11	Direct	12.2 %	12.3 %	11.4 %
	3	Indirect	11.8	11.5	13.9
School	6	Direct	11.0 %	11.1 %	11.6 %
	3	Indirect	8.0	6.9	7.0
University	0	Direct	N/A %	N/A %	N/A %
	1	Indirect	13.7	13.9	13.6

Head Start Grantees Reported Equalling or Exceeding
Statutory Administrative Cost Limit
By Grantee Type

Grantee Self-Report Data

Number Equal or Exceeding 15 Percent Limit by Grantee Type							
Type Grantee	Sample *		1983 No. Grantees	1984 No. Grantees	1985 No. Grantees	3 Year Total	
	No. Grantees	% Total				No. Grantees	% Total
CAA	81	70%	6	6	5	17**	68%
Local Governments	10	9	1	2	1	4***	16
Other Private Non-Profit	14	12	-	1	2	3	12
School	9	8	-	1	-	1	4
University	1	1	-	-	-	-	-
Totals	115	100%	7	10	8	25	100%

* Grantees returning completed questionnaires.

** 5 CAA grantees exceeded limit in two or more years.

*** 1 Local Government grantee exceeded limit in two years.

Head Start Grantees Reported Equalling or Exceeding
Statutory Administrative Cost Limit
By Type Cost

Grantee Self-Report Data

Number Equal or Exceeding 15 Percent Limit by Type Cost							
Type Cost	Sample *		1983	1984	1985	3 Year Total	
	No. Grantees	% Total	No. Grantees	No. Grantees	No. Grantees	No. Grantees	% Total
Direct	77	67%	5	7	5	17	68%
Indirect	38	33	2	3	3	8	32
Totals	115	100%	7	10	8	25	100%

* Grantees returning completed questionnaires.

Head Start Grantees Reported Equalling or Exceeding
Statutory Administrative Cost Limit
By Region

Grantee Self-Report Data

Number Equal or Exceeding 15 Percent Limit by Region							
Region	Sample *		1983	1984	1985	3 Year Total	
	No. Grantees	% Total	No.	No.	No.	No. Grantees	% Total
2	20	17.4%	2	3	2	7	28%
4	35	30.4	3	5	3	11	44
6	29	25.2	1	1	2	4	16
7	17	14.8	-	-	-	-	-
10	14	12.2	1	1	1	3	12
Totals	115	100%	7	10	8	25	100%

* Grantees returning completed questionnaires.

Head Start Grantees Reported Equalling or Exceeding
Statutory Administrative Cost Limit
By Funding Level

Grantee Self-Report Data

Number Equal or Exceeding 15 Percent Limit by Funding Level							
Funding Level (\$ Thousands)	Sample *		1983	1984	1985	3 Year Total	
	No. Grantees	% Total	No. Grantees	No. Grantees	No. Grantees	No. Grantees	% Total
\$ 500 & Below	29	31%	4	2	4	10	40%
500 - 1,000	29	31	2	5	3	10	40
1,000 - 2,000	24	26	-	-	1	1	4
2,000 - 3,000	6	6	-	1	-	1	4
3,000 - 5,000	5	5	1	1	-	2	8
5,000 - Above	1	1	-	1	-	1	4
Totals	94	100%	7	10	8	25	100%

* For 1985 - Grantees returning completed questionnaires with budget and administrative cost data for 1985

Head Start Grantees
Administrative Cost Percentages
By Funding Level

Funding Level (\$ Thousands)	1983		1984		1985	
	No. Grantees	Average Rate	No. Grantees	Average Rate	No. Grantees	Average Rate
\$ 500 & Below	37	11.5%	32	11.8%	29	12.1%
500 - 1,000	27	11.5%	28	11.6%	29	12.0%
1,000 - 2,000	13	9.9%	19	10.1%	24	10.3%
2,000 - 3,000	4	7.8%	7	9.7%	6	9.9%
3,000 - 5,000	6	11.6%	5	11.6%	5	10.9%
5,000 - Above	-	-	1	15.0%	1	15.0%
Total	87		92		94	
Overall Average Rate		10.7%		11.3%		11.2%