

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**ECONOMIC OPPORTUNITIES
DEVELOPMENT CORPORATION OF
ATASCOSA, KARNES, AND WILSON
COUNTIES' FINANCIAL MANAGEMENT
PRACTICES AND SYSTEMS DID
NOT ALWAYS MEET FEDERAL
REQUIREMENTS**

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



Patricia Wheeler
Regional Inspector General

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Office of Inspector General

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EXECUTIVE SUMMARY

BACKGROUND

Title VI of the Omnibus Budget Reconciliation Act of 1981 established Head Start as a Federal discretionary grant program. The major objectives of the Head Start program are to promote school readiness and to enhance the social and cognitive development of low-income children by providing educational, health, nutritional, and social services.

Within the U.S. Department of Health and Human Services (HHS), the Administration for Children and Families, Office of Head Start (OHS), administers the Head Start program. In fiscal year (FY) 2010, Congress appropriated \$7.2 billion to fund Head Start's regular operations.

The American Recovery and Reinvestment Act of 2009 (Recovery Act), P.L. No. 111-5, provided an additional \$2.1 billion for the Head Start program during FYs 2009 and 2010. These funds were intended for activities such as expanding enrollment, funding cost-of-living wage increases for employees of Head Start grantees, upgrading centers and classrooms, and bolstering training and technical assistance.

Economic Opportunities Development Corporation of Atascosa, Karnes, and Wilson Counties (EODC), a nonprofit agency, operates a Head Start program that serves 3- to 5-year-old children and their families at various locations in the three Texas counties. EODC is funded primarily through Head Start grants. During EODC's FY 2010 (December 1, 2009, through November 30, 2010), OHS provided Head Start grant funds to EODC totaling \$2,569,020. On June 30, 2009, OHS provided EODC \$173,944 in Recovery Act funding. EODC also received funds from the U.S. Department of Agriculture.

OBJECTIVE

Our objective was to determine whether EODC's financial management practices and systems met Federal requirements.

SUMMARY OF FINDINGS

EODC's financial management practices and systems did not always meet Federal requirements. Specifically, EODC:

- claimed \$352,487 in construction costs that did not comply with the provisions approved in its applications for Federal construction assistance;
- claimed \$19,285 for fuel expenditures that were not reasonable;
- claimed \$309 for an ineligible salary payment that was not paid in accordance with Federal requirements and personnel policies;

- claimed a total of \$25,769 for an inadequately documented salary increase that was potentially unreasonable;
- claimed \$18,004 in expenditures for construction, maintenance, and repairs that were potentially unsupported;
- did not pay salaries and payments for unused vacation in accordance with Federal requirements and personnel policies;
- did not segregate duties related to bank reconciliations and inventory procedures and ensure that only authorized personnel had access to the accounting system;
- did not enter transactions into the accounting system in a timely manner;
- did not close out the automated accounting system at the end of each year;
- did not safeguard unused checks;
- did not have written policies that adequately addressed conflicts of interest and did not have any written policies that addressed the procurement of consultants;
- did not maintain accurate property record cards on all assets;
- did not properly record the disposition of assets;
- did not properly identify equipment;
- did not properly value donated space, land, and buildings in claiming non-Federal share; and
- did not adequately document in-kind non-Federal share for volunteer services and ensure that they were allowable.

RECOMMENDATIONS

We recommend that OHS:

- require EODC to refund \$372,081 in unallowable costs related to its Head Start grant;
- work with EODC to determine whether the inadequately documented salary increase totaling \$25,769 was reasonable and refund any portion determined to be unreasonable;
- work with EODC to determine whether expenditures for construction, maintenance, and repair payments totaling \$18,004 were supported by adequate documentation;

- impose special award conditions on EODC to ensure that its financial system provides accurate, current, and complete disclosure of financial results and records that identify the source and application of funds for HHS-sponsored activities;
- impose special award conditions on EODC to ensure that it has effective control over and accountability for all funds, property, and other assets and that it adequately safeguards all assets and ensures that they are used solely for authorized purposes; and
- ensure that EODC:
 - claims Head Start expenditures that are allowable,
 - complies with the approved provisions in applications for Federal assistance for construction,
 - monitors the use of credit cards for fuel purchases and increases oversight of credit card use,
 - adequately documents salary increases and follows personnel policies when compensating employees,
 - follows Federal requirements in paying salaries and vacation pay,
 - segregates duties so that individuals who maintain property records are not the same individuals who perform the physical inventory,
 - develops written policies and procedures that adequately address conflicts of interest and written policies that address the procurement of consultants,
 - properly values non-Federal share for donated space, land, and buildings, and
 - adequately documents allowable in-kind non-Federal share for volunteer services.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, EODC did not agree with any of our findings. After we issued our draft report, EODC provided sworn affidavits to support the expenditures for construction, maintenance, and repairs. After reviewing EODC's comments and additional information, we revised the report to set aside those expenditures for OHS to determine whether any were allowable. In addition, we modified our finding on conflicts of interest to acknowledge that EODC had policies and procedures on conflicts of interest but that they were not adequate. Nothing in EODC's comments caused us to change any of our other findings or recommendations. EODC's comments are included in their entirety as Appendix A.

OFFICE OF HEAD START COMMENTS

In its written comments on our draft report, OHS concurred with all of our recommendations. However, OHS stated that its concurrence with the recommendation to refund \$372,081 in unallowable costs was contingent on its determination that EODC failed to utilize \$352,487 for construction as intended. OHS agreed that EODC should refund the remaining \$19,594. OHS's comments are included in their entirety as Appendix B.

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B: OFFICE OF HEAD START COMMENTS

INTRODUCTION

BACKGROUND

Head Start Program

Title VI of the Omnibus Budget Reconciliation Act of 1981 established Head Start as a Federal discretionary grant program. The major objectives of the Head Start program are to promote school readiness and to enhance the social and cognitive development of low-income children by providing educational, health, nutritional, and social services.

Within the U.S. Department of Health and Human Services (HHS), the Administration for Children and Families (ACF), Office of Head Start (OHS), administers the Head Start program. In fiscal year (FY) 2010, Congress appropriated \$7.2 billion to fund Head Start's regular operations.

The American Recovery and Reinvestment Act of 2009 (Recovery Act), P.L. No. 111-5, provided an additional \$2.1 billion for the Head Start program during FYs 2009 and 2010. These funds were intended for activities such as expanding enrollment, funding cost-of-living wage increases for employees of Head Start grantees, upgrading centers and classrooms, and bolstering training and technical assistance.

Economic Opportunities Development Corporation of Atascosa, Karnes, and Wilson Counties

Economic Opportunities Development Corporation of Atascosa, Karnes, and Wilson Counties (EODC), a nonprofit agency, operates a Head Start program that serves 3- to 5-year-old children and their families at various locations in the three Texas counties. EODC is funded primarily through Head Start grants. During EODC's FY 2010 (December 1, 2009, through November 30, 2010), OHS provided Head Start grant funds to EODC totaling \$2,569,020. On June 30, 2009, OHS provided EODC \$173,944 in Recovery Act funding. EODC also received funds from the U.S. Department of Agriculture.

Federal Requirements for Grantees

Federal regulations (45 CFR part 74) establish uniform administrative requirements governing HHS grants and agreements awarded to nonprofit organizations. As a nonprofit organization in receipt of Federal funds, EODC must comply with the cost principles at 2 CFR part 230, *Cost Principles for Non-Profit Organizations* (Office of Management and Budget Circular A-122), incorporated by reference at 45 CFR § 74.27(a). These cost principles specify the criteria that costs must meet to be allowable. The HHS awarding agency may include additional requirements that are considered necessary to attain the award's objectives.

To help ensure that Federal requirements are met, grantees must maintain financial management systems in accordance with 45 CFR § 74.21. These systems must provide for accurate, current, and complete disclosure of the financial results of each HHS-sponsored project or program (45 CFR § 74.21(b)(1)) and must ensure that accounting records are supported by source

documentation (45 CFR § 74.21(b)(7)). Grantees also must have written procedures for determining the allowability of expenditures in accordance with applicable Federal cost principles and the terms and conditions of the award (45 CFR § 74.21(b)(6)).

Section 642(c)(1)(E) of the Head Start Act states that the Head Start agency's governing body shall "be responsible for ensuring compliance with Federal laws (including regulations)"

Special Award Conditions

Pursuant to 45 CFR § 74.14, OHS may impose additional requirements if a grant recipient has a history of poor performance, is not financially stable, does not have a financial management system that meets Federal standards, has not conformed to the terms and conditions of a previous award, or is not otherwise responsible.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether EODC's financial management practices and systems met Federal requirements.

Scope

We performed this review based on a request from OHS. We did not perform an overall assessment of EODC's internal control structure. We reviewed only those internal controls directly related to our audit objective. Our review period was EODC's FY 2010.

We performed our fieldwork at EODC's administrative office in Kenedy, Texas.

Methodology

To accomplish our objective, we:

- reviewed relevant Federal laws, regulations, and guidance;
- reviewed EODC's accounting, procurement, personnel, and financial reporting procedures and interviewed EODC officials to gain an understanding of those procedures;
- reviewed grant award documentation to determine EODC's Head Start and Recovery Act funding;
- reviewed EODC's audited financial statements for FYs 2007 through 2009, as well as unaudited financial statements for FY 2010;¹

¹ The financial statements for FY 2010 had not been audited at the time of our review.

- reviewed EODC's general ledger, timesheets, invoices, bank reconciliations, and other supporting documentation for costs charged to Head Start grants;
- reviewed EODC's property records and performed a physical inventory of selected items at one facility;
- reviewed documentation supporting EODC's non-Federal share for FY 2010;
- reviewed the composition of EODC's Head Start board of directors and board meeting minutes; and
- met with ACF officials to discuss our audit findings.

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

FINDINGS AND RECOMMENDATIONS

EODC's financial management practices and systems did not always meet Federal requirements. Specifically, EODC:

- claimed \$352,487 in construction costs that did not comply with the provisions approved in its applications for Federal construction assistance;
- claimed \$19,285 for fuel expenditures that were not reasonable;
- claimed \$309 for an ineligible salary payment that was not paid in accordance with Federal requirements and personnel policies;
- claimed a total of \$25,769 for an inadequately documented salary increase that was potentially unreasonable;
- claimed \$18,004 in expenditures for construction, maintenance, and repairs that were potentially unsupported;
- did not pay salaries and payments for unused vacation in accordance with Federal requirements and personnel policies;
- did not segregate duties related to bank reconciliations and inventory procedures and ensure that only authorized personnel had access to the accounting system;
- did not enter transactions into the accounting system in a timely manner;

- did not close out the automated accounting system at the end of each year;
- did not safeguard unused checks;
- did not have written policies that adequately addressed conflicts of interest and did not have any written policies that addressed the procurement of consultants;
- did not maintain accurate property record cards on all assets;
- did not properly record the disposition of assets;
- did not properly identify equipment;
- did not properly value donated space, land, and buildings in claiming non-Federal share; and
- did not adequately document in-kind non-Federal share for volunteer services and ensure that they were allowable.

UNALLOWABLE CONSTRUCTION COSTS

Pursuant to 45 CFR § 1309.52(b), all contracts for construction or major renovation of a facility to be paid for in whole or in part with Head Start funds require the prior, written approval of the responsible HHS official and should be paid on a lump-sum, fixed-price basis.

According to the terms of EODC's Financial Assistance Awards for purchasing new facilities, the facilities and construction funds must be used as described in the grantee's application. Prior written approval from the ACF Regional Office is required before the grantee can use the funds for any other purpose.

EODC claimed \$352,487 in construction costs for two facilities. For the first facility, EODC requested \$908,500 from OHS for the estimated costs of purchasing land (\$80,000) and building a Head Start center (\$828,500). OHS agreed to fund \$227,125 of the total estimated costs if EODC funded the remaining \$681,375. The 2011 county district appraisal valued the center at \$108,310 (13 percent of the estimated cost stated in the OHS-approved application). The appraised value was also less than the share of construction costs that OHS agreed to pay.² In addition, rather than purchasing land as specified in the Financial Assistance Award, EODC entered into a lease with the city at an alternative location for \$1 per year and, therefore, did not need the \$80,000 that OHS awarded for the land purchase.

For the second facility, EODC requested \$501,450 from OHS for the estimated costs of purchasing land (\$15,000) and building a Head Start center (\$486,450). OHS agreed to fund \$125,362 of the total estimated costs if EODC funded the remaining \$376,088. The 2011 county

² We compared the OHS-approved costs of construction to the appraised value rather than actual costs because we could not determine actual costs.

district appraisal valued the center at \$86,770 and the land at \$9,500. The appraised values of the center and the land were 19 percent of the estimated cost stated in the OHS-approved application. The appraised values were also less than the share of costs that OHS agreed to pay. Because EODC did not construct these two Head Start centers and fund its share of the land and building costs according to the OHS-approved applications, EODC was not entitled to the \$352,487 in Federal funds awarded.

UNSUPPORTED OR UNREASONABLE DISBURSEMENTS

Federal Requirements

Pursuant to 45 CFR § 74.21(b), grantees are required to maintain financial management systems that have accounting records that are supported by source documentation. Grantees must have effective control over and accountability for all funds, property, and other assets. Recipients should adequately safeguard all such assets and ensure that they are used solely for authorized purposes.

The cost principles at 2 CFR part 230, Appendix A, section A.2, state that to be allowable under an award, costs must be reasonable and adequately documented.

The cost principles at 2 CFR part 230, Appendix A, section A.3, state that a cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs.

The cost principles at 2 CFR part 230, Appendix B, section 8.h, state that the “portion of the cost of organization-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable as fringe benefit or indirect costs regardless of whether the cost is reported as taxable income to the employees. These costs are allowable as direct costs to sponsored award when necessary for the performance of the sponsored award and approved by awarding agencies.”

*The HHS Grants Policy Statement (HHS GPS)*³ states:

HHS requires recipients to establish safeguards to prevent employees, consultants, members of governing bodies, and others who may be involved in grant-supported activities from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private financial gain for themselves or others, such as those with whom they have family, business, or other ties. These safeguards must be reflected in written standards of conduct.

Unsupported or Unreasonable Fuel Purchases

EODC’s written procedures state that vehicles owned by EODC should be used only for Head Start purposes, that a travel log should be kept in each vehicle and maintained by staff who drive

³ The HHS GPS states the general terms and conditions applicable to HHS discretionary grants and is applicable by incorporation into the terms and conditions of the individual award.

these vehicles for agency business. In addition, policies on local travel state that, if authorized, an employee may claim mileage reimbursement for use of a personal vehicle by preparing a local-mileage travel report. This report must be approved and signed by a supervisor.

EODC claimed \$19,285 in unreasonable and unsupported expenditures for fuel.

- EODC claimed \$17,982 in purchases made on the Head Start director's assigned credit cards (from October 2009 through October 2010). We calculated that the Head Start director would have needed to drive more than 80,000 miles per year (or 160,000 miles over a 2-year period) to accumulate \$17,982 in fuel charges.⁴ However, using the odometer readings indicated on the purchase and sale invoices for the agency-owned vehicle, we determined that the Head Start director drove the vehicle 69,174 miles over a 2-year period.
- EODC claimed \$1,303 in additional fuel purchases made with the fiscal/office manager's assigned credit card (November 2009 through October 2010) by the fiscal/office manager, who said that she drove her own vehicle for Head Start business. However, she informed us that she did not prepare travel logs, and EODC officials could not provide any other support for these expenditures.

Unsupported Construction, Maintenance, and Repairs

EODC's written procedures require that supporting documentation be kept with each check stub. EODC claimed \$18,004 in unsupported payments to individuals for construction, maintenance, and repairs. Of this amount, EODC reimbursed \$14,794 to the Head Start director for cash payments he said he had made to individuals (e.g., a \$1,200 reimbursement for maintenance) and a family member (e.g., a reimbursement for \$400 cash paid for use of a truck and trailer and help moving storage buildings) using his own money. EODC reimbursed the fiscal/office manager \$1,035 for cash payments she said she had made to family members for grounds maintenance. Also, EODC used checks to pay family members an additional \$2,175 for grounds maintenance during our review period.

EODC provided sworn affidavits for the payments made to the individuals. Because most of the affidavits did not reconcile to the entries listed in the Head Start director's notebook, we are unable to rely on these affidavits as supporting documentation for the cash payments for construction, maintenance, and repairs. Therefore, we are setting aside the \$18,004 for further review by OHS.

SALARIES

Federal Requirements

The cost principles at 2 CFR part 230, Appendix A, section A.2, state that to be allowable under an award, costs must be adequately documented.

⁴ We used a mileage calculation for the vehicle of 14 miles per gallon at \$3 a gallon. These are conservative estimates based on the vehicle type and regional gas prices at the time the fuel was used.

The cost principles at 2 CFR part 230, Appendix B, section 8.c.2, state that to be reasonable, compensation for employees in organizations predominantly engaged in Federally sponsored activities should be comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved. Similarly, section 653 of the Head Start Act (42 U.S.C. § 9848) provides that Head Start employees may not receive compensation: "... in excess of the average rate of compensation paid in the area where the program is carried out to a substantial number of persons providing substantially comparable services, or in excess of the average rate of compensation paid to a substantial number of the persons providing substantially comparable services in the area of the person's immediately preceding employment"

The cost principles at 2 CFR part 230, Appendix B, section 8.b.1, state that the costs of salaries, fringe benefits, and cost-of-living differentials are allowable to the extent that total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities.

Ineligible Salary Payment

EODC claimed \$309 for an unallowable payment it made to a "full-year, full-day" classroom aide for holiday hours. EODC's personnel policies state that employees who hold the position "full-year, full-day" classroom aide are not eligible for any benefits except those which EODC is required to provide. EODC is not required to pay these types of employees for holiday hours.

Inadequately Documented Salary

EODC claimed an inadequately documented salary increase for the fiscal/office manager totaling \$25,769. This amount is the difference between her previous salary and her new salary.

According to the board meeting minutes, the board approved the salary increase based on additional responsibilities and on a wage comparability study. However, EODC did not provide the wage comparability study to us; therefore, we could not determine how EODC used it to determine the amount of the monthly salary increase. In addition, when we compared the new duties and responsibilities with the previous ones, the only difference was a new duty to act as assistant Head Start director/contact person if the Head Start director was unavailable. Because we did not receive a wage comparability study and the change in responsibilities was minimal, we could not determine whether the increase was reasonable. Therefore, we are setting aside the \$25,769 for further review by OHS.

PREPAID SALARIES AND VACATION

Federal Requirements

The cost principles at 2 CFR part 230, Appendix A, section A.3, state:

A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the

time the decision was made to incur the costs.... In determining the reasonableness of a given cost, consideration shall be given to: (a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.... (c) Whether the individuals concerned acted with prudence in circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Federal Government.

The cost principles at 2 CFR part 230, Appendix B, section 8.g.1, state that fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable, provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

The cost principles at 2 CFR part 230, Appendix B, section 8.m.2, state:

Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards.... Reports maintained by non-profit organizations to satisfy these requirements must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

The cost principles at 2 CFR part 230, Appendix B, section 8.b.1, state that the costs of salaries, fringe benefits, and cost-of-living differentials are allowable to the extent that total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Federal and non-Federal activities.

Prepaid Salaries

EODC prepaid the Head Start director his last paycheck of FY 2010 (\$6,108) over the 6-month period before it was earned and recorded the payments as salary expenses. Prepaying the Head Start director for his last paycheck before it was earned was unreasonable because the prepayment was not (1) ordinary and necessary for the operation of the organization or performance of the award and (2) prudent, in this instance, because the Head Start director could have terminated his employment with EODC, and EODC might not have been able to recover the prepaid salaries.

Employee Advances

EODC's policies allowed employees to receive what EODC officials referred to as "payroll advances" on their salaries. For example, during FY 2010, the Head Start director received and paid back \$7,825 in advances, and two other employees received \$1,500 in advances. In addition, EODC's policies did not address a timetable for repaying advances, and EODC did not take regular deductions from the employees' paychecks for these advances. These actions were

not prudent under the circumstances because, if an employee had received advances on salaries and stopped employment, EODC might not have been able to recover the advances.

Prepaid Vacation Time

EODC's vacation policy states that employees who are scheduled to work 12 months in the administrative office will receive paid vacation. Administrative office employees may sell back all or part of their accrued vacation if they are unable to take the time because they need to maintain the stability of critical functions of EODC.

EODC did not follow either Federal requirements or its written personnel policies for selling back vacation time. EODC paid the Head Start director for his vacation time before he earned it. Prepaying vacation time was not prudent because, if an employee who had received compensation for unearned leave stopped employment, EODC may not have been able to recover the vacation time pay.

Two other employees sold back their vacation time each month as they earned it. In most cases, the Head Start director could not have determined whether he and his staff would have been able to use the vacation time before they sold the time back.⁵

INTERNAL CONTROLS

Federal Requirements

Pursuant to 45 CFR § 74.21(b), grantees are required to maintain financial management systems that provide accurate, current, and complete disclosure of the financial results of each federally sponsored project or program in accordance with the reporting requirements set forth in 45 CFR § 74.52. In addition, grantees must maintain accounting records that are supported by source documentation and have effective control over and accountability for all funds, property, and other assets. Recipients also should adequately safeguard all such assets and ensure that they are used solely for authorized purposes.

Pursuant to 45 CFR § 1304.50(g)(2): "Grantee and delegate agencies must ensure that appropriate internal controls are established and implemented to safeguard Federal funds in accordance with 45 CFR § 1301.13."

Inadequate Segregation of Duties

EODC did not have adequate segregation of duties. EODC's written procedures state that the Head Start director should sign checks, and the accounting clerk should forward them to a board member for a cosignature. However, in September 2000, the EODC Head Start board granted the fiscal/office manager the authority to sign checks when none of the three board members authorized to sign checks could be contacted. EODC could not provide evidence that a board member had signed a check since September 2000. The fiscal/office manager reconciled the

⁵ EODC employees historically have sold back all of their vacation time.

bank account and could sign checks. Permitting the same individual responsible for the bank reconciliation to sign checks provides that individual with an increased opportunity to divert funds.

In addition, the fiscal/office manager maintained the property record cards, which are used to maintain the inventory of assets, and performed physical inventories. Inventories should be completed by individuals who are not also responsible for maintaining the inventory log. However, the Procurement and Property Management Policies appendix in the *Accounting Policies and Procedures Manual* allows the fiscal/office manager to maintain inventory records and perform biannual physical inventories.

EODC's written procedures state that "the only people having access to the accounting system are: 1) the fiscal manager, 2) the accounting clerk, and 3) the general office clerk." Even though written procedures stated that the Head Start director should not have access to the accounting system, interviews with staff indicated that the Head Start director had access to the accounting system using the server computer and an administrative password. Access to the accounting system gave the Head Start director the ability to circumvent safeguards that were in place.

Untimely and Incomplete Disclosure in the Financial Management System

EODC's written procedures state that transactions should be identifiable and recorded in the accounting system in a timely manner. EODC did not enter transactions into the automated accounting system in a timely manner. The fiscal/office manager entered transactions manually into a ledger and then transferred the batch totals into EODC's automated accounting system at the end of each month. Thus, individual transactions were not identifiable in the automated accounting system, and EODC was unable to give up-to-date financial information to the Head Start board for its meetings. In addition, EODC did not close the accounts in the automated system at the end of the year. Because of these conditions, EODC was not able to provide current and complete disclosure of financial results.

Checks Not Safeguarded

EODC's written procedures state that unused checks should be kept in locked storage. During our walkthrough at EODC, we found unsecure, unused checks. Such checks could have been accessed by unauthorized individuals.

PROCUREMENT POLICIES AND PROCEDURES

Regulations (45 CFR § 74.43) state: "Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered." Further, 45 CFR § 74.44(a) states that grantees of Federal awards must implement written procurement procedures for solicitation of goods and services. The HHS GPS states:

HHS requires recipients to establish safeguards to prevent employees, consultants, members of governing bodies, and others who may be involved in grant-

supported activities from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private financial gain for themselves or others, such as those with whom they have family, business, or other ties. These safeguards must be reflected in written standards of conduct.

Exhibit 4 of the HHS GPS, page II-32, requires grantees to have written policies for the use of consultants.

The cost principles at 2 CFR part 230, Appendix B, section 37.b, state that in determining the allowability of consultants' costs, the following factors, among others, are relevant: (1) the nature and scope of services provided in relation to the service required and (2) the qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Federal awards.

EODC's written policies and procedures did not adequately address conflicts of interest. In addition, EODC did not have a written policy regarding the use of consultants. Specifically, EODC did not have procedures for (1) selecting the most qualified individual available, (2) determining the nature and extent of the services to be provided, and (3) ensuring that the fees are reasonable in accordance with the cost principles at 2 CFR part 230, Appendix B, section 37.

PROPERTY AND EQUIPMENT RECORDS

Pursuant to 45 CFR § 74.21(b), grantees must maintain accounting records that are supported by source documentation and have effective control over and accountability for all funds, property, and other assets.

Pursuant to 45 CFR § 74.34(f), grantees are required to maintain accurate records for equipment acquired with Federal funds. The records should include identifying information, including identification numbers, such as model or serial numbers; acquisition dates and costs; and ultimate disposition data.

EODC's written procedures describe its process for reconciling physical inventory with written inventory records. Despite these written procedures, we found that EODC's:

- property record cards did not agree with the schedule of fixed assets,
- property did not have its disposition properly recorded, and
- equipment was not properly identified to show ownership.

Property Record Cards Did Not Agree With Schedule of Fixed Assets

EODC's property record cards did not agree with the schedule of fixed assets.⁶ For example, a property record card showed that a vehicle was traded in on November 30, 2008; however, it

⁶ Property record cards describe the property, list the purchase date, and give the original value of the property.

remained on the November 30, 2009, schedule of fixed assets. In another instance, EODC purchased a vehicle on November 26, 2008, and sold it without recording the transactions on a property record card or the schedule of fixed assets.⁷

Property Disposition Was Not Properly Recorded

EODC did not properly record the disposition of assets. For example, a hand-written note on the property record card showed that a vehicle was removed from inventory on November 30, 2009, because it was not repairable. However, it was still listed on the schedule of fixed assets for November 30, 2009. The property record card had no information regarding where the vehicle was discarded or any salvage value.

In addition, discarded copiers with a depreciable value remained on the schedule of fixed assets. Also, EODC did not have a property record card for a portable building that was recorded on the schedule of fixed assets at \$10,750. EODC officials were unable to ascertain the disposition of the portable building.

Equipment Was Not Properly Identified

EODC did not properly identify equipment. For example, the equipment at the Head Start center we visited was not tagged or identified as equipment purchased with EODC or Head Start funds.

NON-FEDERAL SHARE

Pursuant to 45 CFR § 1301.20, grantees are to provide 20 percent of the total cost of the program through non-Federal share unless an exception applies. Pursuant to 45 CFR § 74.23(a), matching contributions, to be acceptable, must be necessary and reasonable for properly and efficiently accomplishing program objectives and be verifiable from the recipient's records.

Pursuant to 45 CFR § 74.23(h)(1), the value of donated land and buildings at the time of donation to a recipient should not exceed their fair market value as established by an independent appraiser (e.g., certified real property appraiser or General Services Administration representative) and certified by a responsible official of the recipient.

Pursuant to 45 CFR § 74.23(h)(3), the value of donated space should not exceed the fair rental value of comparable space as established by an independent appraisal of comparable space and facilities in a privately owned building in the same locality.

Pursuant to 45 CFR § 74.23(i)(2), the basis for determining the valuation for personal services, material, equipment, buildings, and land must be documented.

OHS required EODC to provide \$642,255 in non-Federal share; however, EODC reported \$882,445. We were unable to determine whether the amount reported for donated space, land,

⁷ This was the agency-owned vehicle used by the Head Start director and referenced in the "Unsupported or Unreasonable Fuel Purchases" section of this report.

and buildings was correctly valued because EODC did not have independent appraisals performed. In addition, EODC did not adequately document volunteer services.

Improperly Valued Donated Space, Land, and Buildings

EODC claimed \$85,848 in non-Federal share for donated space, land, and buildings. Regarding donated space, EODC did not have the fair rental value of comparable space determined by an independent appraiser. EODC determined the value of the non-Federal share by multiplying the county's appraised tax value by 25 percent and deducting any rent paid on each space, if applicable. An EODC official stated that EODC was unable to have space independently appraised because appraisal costs were too expensive.

Regarding donated land and buildings, EODC did not have the fair market value determined by an independent appraiser at the time of the donation, and an EODC official did not certify the fair market value. EODC determined the value of the non-Federal share by multiplying the county's appraised tax value by 25 percent. An EODC official stated that EODC was unable to have the land and buildings independently appraised because appraisal costs were too expensive.

Inadequately Documented Volunteer Services

EODC reported \$795,228 in in-kind non-Federal share for volunteer services. EODC did not adequately document volunteer services on monthly timecards EODC provided to volunteers to list their activities. Some of the timecards had hours for which there were no documented activities. Other timecards included activities that were not allowable program costs (e.g., eating breakfast with children and fundraising activities).

RECOMMENDATIONS

We recommend that OHS:

- require EODC to refund \$372,081 in unallowable costs related to its Head Start grant;
- work with EODC to determine whether the inadequately documented salary increase totaling \$25,769 was reasonable and refund any portion determined to be unreasonable;
- work with EODC to determine whether expenditures for construction, maintenance, and repair payments totaling \$18,004 were supported by adequate documentation;
- impose special award conditions on EODC to ensure that its financial system provides accurate, current, and complete disclosure of financial results and records that identify the source and application of funds for HHS-sponsored activities;
- impose special award conditions on EODC to ensure that it has effective control over and accountability for all funds, property, and other assets and that it adequately safeguards all assets and ensures that they are used solely for authorized purposes; and

- ensure that EODC:
 - claims Head Start expenditures that are allowable,
 - complies with the approved provisions in applications for Federal assistance for construction,
 - monitors the use of credit cards for fuel purchases and increases oversight of credit card use,
 - adequately documents salary increases and follows personnel policies when compensating employees,
 - follows Federal requirements in paying salaries and vacation pay,
 - segregates duties so that individuals who maintain property records are not the same individuals who perform the physical inventory,
 - develops written policies and procedures that adequately address conflicts of interest and written policies that address the procurement of consultants,
 - properly values non-Federal share for donated space, land, and buildings, and
 - adequately documents allowable in-kind non-Federal share for volunteer services.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, EODC did not agree with any of our findings. After we issued our draft report, EODC provided sworn affidavits to support the expenditures for construction, maintenance, and repairs. After reviewing EODC's comments and additional information, we revised the report to set aside those expenditures for OHS to determine whether any were allowable. In addition, we modified our finding on conflicts of interest to acknowledge that EODC had policies and procedures on conflicts of interest but that they were not adequate. Nothing in EODC's comments caused us to change any of our other findings or recommendations. EODC's comments are summarized below and included in their entirety as Appendix A.

Claimed Construction Costs That Did Not Comply With the Provisions Approved in Its Applications for Federal Construction Assistance

Auditee Comments

EODC disagreed with our finding, stating that (1) we misstated the facts surrounding subsequent amendments to EODC's application, (2) our conclusions were not consistent with the OHS grant of funds to EODC, and (3) it was improper for us to have claimed that we could not determine actual construction costs for the projects because it provided us with documentation.

EODC agreed that OHS agreed to fund \$227,125 of the total estimated cost to buy land and construct a Head Start Center in Karnes City if EODC funded the remaining balance. EODC indicated that it purchased a 50-year lease at a cost of \$1 per year for an alternative site because the originally proposed site was no longer available. EODC stated that we did not look at the circumstances surrounding the construction project or interview the local program specialist. It indicated that if we had done so, we would be aware of the “EODC Director’s actions in securing OHS approving” the alternative construction site and the lease terms for the property. EODC stated that the HHS program specialist did not indicate that EODC would need to get further approval from HHS or OHS and that the program specialist conducted an onsite visit and expressed approval of the project.

EODC stated that the failure to purchase land was not a violation of the Financial Assistance Award’s (FAA) terms. It further indicated that the estimate for the purchase of the land was only \$80,000 of the total \$908,500 project cost; therefore, even if all of the \$227,125 in grant funds had been expressly apportioned for the sole purpose of purchasing the property, the majority of the FAA grant would still be dedicated to the construction of a facility at the site. EODC said that our conclusion that OHS awarded \$80,000 solely for a land purchase was not supported by the FAA’s terms. EODC also indicated that it was improper for us to state that EODC should be required to repay either \$80,000 or \$227,500 as an unallowable cost on the first facility because EODC negotiated a reduction in cost.

For the Stockdale facility, EODC indicated that our disapproval was based solely on our comparison of OHS’s grant amount with the current Karnes County Central Appraisal District’s appraised value of the property.⁸ EODC further stated that it was improper to compare the construction costs of a building in 2006-2007 to the 2011 county appraisal district value to determine whether OHS funds were properly expended, especially because of the decline in real estate prices in recent years. EODC stated that its personnel provided us with access to documentation regarding the original 2007 appraised value of the property, original purchase price, and original construction costs.

Office of Inspector General Response

We disagree that we misstated the facts surrounding the “subsequent amendments” to EODC’s application. EODC did not provide documentation of any amendments to the original applications provided to us by OHS.

We believe that our conclusions were consistent with OHS’s grant to EODC. According to the OHS-approved FAA, EODC was to pay \$681,375 (75 percent) of the construction costs of the Karnes facility. Correspondence between the Head Start director and the HHS program specialist indicated that the project would not be fully funded nor 75 percent federally funded as requested. According to this correspondence, the Federal Government would pay no more than 25 percent of the facility’s cost. EODC did not fund the additional 75 percent of the facility’s cost and, instead, chose to build the facility with the \$227,125 (25 percent) awarded by OHS.

⁸ According to our records, the Stockdale appraisals were conducted by the Wilson County Appraisal District.

Negotiating a better contract for land did not constitute paying for 75 percent of the facility. EODC should have obtained prior, written approval from OHS so that OHS could determine the new amount that it would fund for the construction costs. In previous correspondence, the Head Start director indicated that any future changes would be made in writing and approvals sought at all levels.

For the Stockdale facility, we used the 2011 Wilson County appraised value because EODC did not provide us with adequate documentation of actual construction costs. The appraisal was the best current estimate of what the facility was worth because it appraised at \$96,270. The 2007 appraisal valued the Stockdale facility at \$43,160; the 2008 appraisal valued it at \$51,770. EODC was awarded \$125,362, which was meant to fund no more than 25 percent of the total estimated facility costs of \$501,450. Because EODC did not obtain loans for the Karnes City and Stockdale facilities, OHS paid for 100 percent of the construction costs for both.

As noted, EODC did not provide us with construction costs. EODC had a ledger that included accounts with various maintenance costs, and it asked us to leave the premises before we could determine which costs were for the construction of the facilities and which were general maintenance costs.

Claimed Expenditures That Were Not Reasonable or Supported by Source Documentation for Construction, Maintenance, Repairs, and Fuel

Auditee Comments

EODC disagreed with our finding, stating that we ignored the source documentation EODC provided to us for all expenditures for construction, maintenance, and fuel. EODC stated that a large portion of these expenditures were for payments made to laborers at the Karnes City Head Start construction project and for purchases of fuel for vehicles traveling to and from the construction site to deliver materials and transport workers. Additionally, EODC stated that we ignored the EODC director's and staff's "repeated corroboration" that the aggregate fuel usage reflected not just the Head Start director's purchases but purchases made for the Karnes City construction project. In addition, EODC stated that it sent us sworn affidavits regarding construction salaries.

Office of Inspector General Response

EODC provided us fuel receipts without any documentation indicating how the fuel was used. The Head Start director purchased the fuel near the construction site as well as at other locations. In an interview with the Head Start director, he told us that he was the only user of the card and that he occasionally fueled a maintenance worker's vehicle. He never indicated that the card was used for multiple purchases of fuel for vehicles involved with the construction work. Furthermore, there was no indication, in our analysis of EODC's statements, of aggregate fuel purchases made with his credit card or other fuel credit cards at any one time. EODC did not address the fiscal/office manager's fuel purchases.

EODC's documentation for cash payments to individuals for construction, maintenance, and repairs was in the form of a small notebook kept by the Head Start director. EODC did not provide any supporting documentation showing that the individuals had been paid, nor was there supporting documentation for reimbursements made to the Head Start director for cash paid to the workers. EODC did not address cash payments made to the fiscal/office manager for maintenance reimbursements.

EODC provided us with sworn affidavits for cash payments to individuals for construction, maintenance, and repairs with its response to our report. These affidavits were signed in 2012 for cash payments received in FY 2010. Because most of the affidavits did not reconcile to the entries listed in the Head Start director's notebook, we are unable to rely on these affidavits as supporting documentation for the cash payments for construction, maintenance, and repairs. Therefore, we are setting aside the \$18,004 for further review by OHS.

Finally, if the fuel costs and day laborer costs were related to the construction of the Karnes City facility, then they were further violations of the agreed-upon FAA for the construction of the facility because they would represent Federal money used in addition to the \$227,125 awarded.

Claimed Ineligible Salary Payment That Was Not Paid in Accordance With Federal Requirements and Personnel Policies

Auditee Comments

EODC disagreed with our finding, stating that no employees were paid ineligible salaries and that we believed that salary paid to full-year, full-day staff during June and August was holiday pay. EODC stated that full-year, full-day classroom aides were permanent employees and that they received benefits. In addition, EODC stated that we misunderstood the difference between full-year, full-day classroom aides and disabilities aides, who were temporary and did not receive benefits other than those EODC was required to provide.

Office of Inspector General Response

We did not misunderstand the salary paid to the full-year, full-day classroom aide. The employee's timesheet and other documentation identified the employee as a full-year, full-day classroom aide and showed that the employee received holiday pay in December. EODC's personnel policies state that employees who hold the position "full-year, full-day" classroom aide are not eligible for any benefits except those which EODC is required to provide and that EODC would pay this type of employee only for time worked.

Claimed Inadequately Documented Salary Increase That Was Potentially Unreasonable

Auditee Comments

EODC disagreed with our finding, stating that the job description for the fiscal/office manager was revised to include duties and responsibilities in addition to acting as the assistant Head Start director when the director was unavailable. EODC said that the assistant director's duties and

responsibilities included preparing agendas and materials for the Tri-County Board and Head Start policy council meetings, acting as the contract person for the administrative office when the Head Start director was not immediately available, securing lease agreements for in-kind space, and obtaining estimates for minor repairs and maintenance projects. EODC also stated that the additional responsibilities did not apply only when the director was unavailable, although the increase in salary was partially justified by the fact that the director was consistently unavailable to handle these day-to-day responsibilities because of travel between the Head Start centers. Furthermore, EODC stated that it was an \$11,796 annual increase, not a \$25,769 increase.

Office of Inspector General Response

In previous correspondence, EODC officials stated that the salary schedule for the fiscal/office manager position was adjusted in accordance with the prevailing wage for similar positions. EODC did not provide a wage comparability study to help us determine how EODC used it to determine the amount of the monthly salary increase. Although EODC stated that the increase was based on additional duties and responsibilities, when we compared the fiscal/office manager's new 2009 job description with the 2007 job description, the only difference was to act as assistant Head Start director/contact person for EODC when the Head Start director was unavailable. The \$25,769 increase is the total difference between her new salary, with two cost-of-living increases, and her old salary with the two cost-of-living increases.

Did Not Pay Salaries and Payments for Unused Vacation in Accordance With Federal Requirements and Personnel Policies

Prepaid Salaries

Auditee Comments

EODC disagreed with our finding, stating that EODC did not pay the Head Start director for his last paycheck of FY 2010 over the 6-month period before it was earned and recorded as salary expenses.

Office of Inspector General Response

An interview with an EODC official and documentation provided by EODC supports that EODC prepaid the Head Start director his last paycheck of FY 2010 over the 6-month period before it was earned and recorded the payments as salary expenses.

Prepaid Vacation Time

Auditee Comments

EODC disagreed with our finding, stating that no vacation time was ever sold before it was earned. In addition, EODC stated that the Head Start director was paid his vacation for FY 2010 on December 1, 2010, which was the last of the EODC fiscal year, and that all his vacation days had been accrued as of the day he was paid for them.

Office of Inspector General Response

In a previous interview, an EODC official stated that the Head Start director was paid for his FY 2010 unused vacation at the beginning of the fiscal year. In addition, documentation provided by EODC showed that the Head Start director was paid for his unused vacation on December 4, 2009, not December 1, 2010.

EODC did not comment on our finding on employee advances.

Did Not Segregate Duties Related to Bank Reconciliations and Inventory Procedures and Ensure That Only Authorized Personnel Had Access to the Accounting System

Auditee Comments

EODC disagreed with our finding, stating that segregation of duties was maintained as much as possible with a small administrative staff. In addition, EODC stated that only authorized personnel had access to the accounting system and that the Head Start director could not access the accounting system.

Office of Inspector General Response

EODC's policies and procedures indicated that checks were to be signed by the Head Start director and a board member, which separated this duty from the fiscal/office manager's responsibility of reconciling the bank accounts. However, EODC was not able to provide evidence that a board member had cosigned a check since September 2000, even though EODC officials indicated that they were aware of the policy. The only individuals who had signed checks were the Head Start director and the fiscal/office manager. In addition, EODC did not segregate the duties of maintaining the inventory of assets and performing physical inventories.

Although EODC stated that the Head Start director did not have access to the server or accounting modules, our interviews with office staff indicated that the Head Start director used an administrative password to access the accounting system.

Did Not Enter Transactions Into the Accounting System in a Timely Manner

Auditee Comments

EODC disagreed with our finding, stating that entering transactions manually into a ledger and then transferring the batch totals into EODC's automated accounting system at the end of each month was not a violation of its policies and procedures. In addition, EODC stated that it appears that we were requiring EODC to enter individual transactions into the automated system daily, which was not required by EODC's policy or Federal regulation.

Office of Inspector General Response

Although EODC recorded individual transactions in the manual journal, analyzing the financial situation at EODC at any given time was difficult because EODC entered batch transactions into the system monthly. We did not require EODC to enter transactions into the automated system daily. However, all accounts need to be kept current for balances to be available on short notice. In previous correspondence, the Head Start director indicated that EODC had obtained technical assistance and had fully automated the accounting system.

Did Not Close Out the Automated Accounting System at the End of Each Year

Auditee Comments

EODC disagreed with our finding, stating that we were aware that EODC recorded transactions and closed the accounts within 90 days of the end of the fiscal year, which was December 1, and that the accounts were then made available to the independent auditor. In addition, EODC stated that the accounts and records were all issued in compliance with the applicable regulations and in a condition conducive to the independent auditor conducting a timely and accurate audit.

Office of Inspector General Response

It was EODC's responsibility to ensure that all accounts were properly closed at the end of each fiscal year. We saw several instances of accounts in the automated system that had large accumulated balances that should have been closed out. Furthermore, in previous correspondence, the Head Start director agreed with our finding and indicated that "the full automation of the accounting system, which had now taken place, required that the automated accounting system be closed out at the end of each fiscal year."

Did Not Safeguard Unused Checks

Auditee Comments

EODC disagreed with our finding, stating that unused checks were kept in a locked filing cabinet. EODC stated that the instance referred to in the audit report occurred when no one else was in the office except a general office clerk and one of the OIG auditors. EODC said that the general office clerk had stepped away from her desk for a moment, but had remained in the same room, and left the blank checks face down on her desk. In addition, EODC stated that this was an isolated incident and not indicative of daily activity at the EODC office.

Office of Inspector General Response

We disagree with EODC's response. During our review, two OIG auditors conducted a physical walkthrough of the EODC office. The accounting clerk had unused checks in a lockable cabinet, but the cabinet was not locked at the time. The general office clerk had unused checks on her desk. She indicated that the checks had been on her desk since the office move, which was a few

months prior to our visit. She also stated that she needed to keep them locked up but had not started doing so.

Did Not Have Written Policies That Adequately Addressed Conflicts of Interest and Procurement of Consultants

Auditee Comments

EODC disagreed with our finding, stating that EODC's policies addressed conflicts of interest. EODC stated that its personnel policies list consultants as those persons with whom EODC contracts to provide expertise in a particular area. EODC stated that the fact that consultants were included in EODC's "classification of employee" indicates that the policies allow the employment of consultants as needed.

Office of Inspector General Response

We agree that EODC had a conflict of interest policy, which stated that employees and board members may not accept gifts, money, gratuities, services, or anything of monetary value from persons who receive benefits or services from EODC, perform services under contract to EODC, or are otherwise in a position to benefit from EODC's actions. However, EODC's policies did not address conflicts of interest on hiring family. EODC's policies did not mention any safeguards for keeping employees, board members, consultants, and others involved with grant-supported activities from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private financial gain for others, such as those with whom they have family, business, or other ties other than stating employees cannot serve on the board and that persons related to employees are not to serve on the board or policy council.

We did not question EODC's ability to contract consultants. EODC did not have policies in place on the use and procurement of consultants. EODC should have policies and procedures in place that describe the procedures for selecting the most qualified individual available, determining the nature and extent of the services to be provided, and ensuring that the fees are reasonable in accordance with the cost principles at 2 CFR part 230, Appendix B, section 37. In previous correspondence with EODC, EODC officials stated that EODC did not have policies on the use of consultants, and the policies we were provided did not discuss the use of consultants.

Did Not Maintain Accurate Property Record Cards on All Assets

Auditee Comments

EODC disagreed with our finding, stating that accurate property records were maintained on all assets. EODC stated that the property records provided to us by the current independent auditor were inaccurate because they were from the previous independent auditor. In addition, EODC stated that the records maintained by EODC's fiscal manager at the administrative office were complete and accurate. EODC further stated that, during our audit, the fiscal manager and an OIG auditor reconciled the property records to the list provided by the independent auditor and that all items were accounted for.

Office of Inspector General Response

The accuracy of the property records can be determined only by reconciling the property records to the assets. We determined that EODC did not maintain property record cards on all assets. Although we made attempts to contact the current independent auditor, she did not respond and never provided us with any documentation. The fiscal/office manager provided all the information we received related to the property records. An OIG auditor and the fiscal/office manager attempted to reconcile the property records but could not. In previous correspondence, the Head Start director acknowledged that “the agency has since reconciled the information with its auditor, and all information agrees.”

Did Not Properly Record the Disposition of Assets

Auditee Comments

EODC disagreed with our finding, stating that the disposition of assets was recorded on the inventory cards appropriately and that the proper entries were made to remove them from EODC’s fixed assets as they became unrepairable or unusable or when they were traded in or sold. In addition, EODC stated that recording the disposition of assets was an ongoing process that was handled by the proper EODC administrative staff but that the records were not regularly updated by EODC’s independent auditor. EODC stated that it was unaware that the independent auditor’s list contained inaccurate information until we requested that EODC obtain a list of fixed assets from the independent auditor.

In addition, EODC stated that it had pointed out the discrepancy to us and independently documented the accuracy of all assets listed in EODC’s inventory. EODC said that, therefore, our conclusion was incorrect because EODC properly recorded the disposition of assets. EODC stated that it was the independent auditor and, by extension, the OIG that relied on the inaccurate information.

Office of Inspector General Response

Regulations require that grantees maintain accurate records for equipment acquired with Federal funds. EODC was responsible for the accuracy of the information provided to the independent auditor.

Did Not Properly Identify Equipment

Auditee Comments

EODC disagreed with our finding, stating that each inventory listing had a serial number, or in the case of a modular building, a description of the building and model number.

Office of Inspector General Response

We disagree with EODC's response. EODC should have tagged equipment purchased with EODC or Head Start funds; however, EODC did not.

Did Not Properly Value Donated Space, Land, and Buildings in Claiming Non-Federal Share

Auditee Comments

EODC disagreed with our finding, stating that it had attempted to obtain appraisals from independent appraisers for donated space, land, and buildings but that it did not receive a response from the appraisers or that their fees were too high. In addition, EODC stated that it based the value of the donated space, land, and buildings on appraisals obtained from Atascosa, Karnes, and Wilson counties.

Office of Inspector General Response

EODC should have had independent appraisals performed to ensure that EODC did not claim more than the fair rental value of comparable space or fair market value in non-Federal share for donated space, land, and buildings. The county's appraised tax value may not reflect the fair rental value or fair market value.

Did Not Adequately Document In-Kind Non-Federal Share for Volunteer Services and Ensure That They Were Allowable

Auditee Comments

EODC disagreed with our finding, stating that administrative office personnel verified the value of the time donated and that it was recorded by the fiscal manager and entered in the accounting system monthly. EODC stated that personnel who document the non-Federal share at the center level were trained in recognizing allowable in-kind contributions and that they were diligent in examining the documentation.

Office of Inspector General Response

We disagree with EODC's response. Volunteer timesheets did not adequately document the types of activities performed, and EODC personnel did not ensure that non-Federal share for volunteer services was allowable.

OFFICE OF HEAD START COMMENTS

In its written comments on our draft report, OHS concurred with all of our recommendations. However, OHS stated that its concurrence with the recommendation to refund \$372,081 in unallowable costs was contingent on its determination that EODC failed to utilize \$352,487 for

construction as intended. OHS agreed that EODC should refund the remaining \$19,594. OHS's comments are included in their entirety as Appendix B.

APPENDIXES

APPENDIX A: AUDITEE COMMENTS

Jennifer S. Riggs
*Board Certified in Administrative Law
Texas Board of Legal Specialization*
jriggs@r-alaw.com

Jason Ray
*Board Certified in Administrative Law
Texas Board of Legal Specialization*
512 457-9812 – direct line
jray@r-alaw.com

RIGGS ALESHIRE & RAY
A PROFESSIONAL CORPORATION
ATTORNEYS AND COUNSELORS

700 LAVACA ST., SUITE 920
AUSTIN, TEXAS 78701
512 457-9806 TELEPHONE
512 457-9066 FACSIMILE

Bill Aleshire
*Member, College of
The State Bar of Texas*
aleshire@r-alaw.com

Laura Diamond
*Member, College of
The State Bar of Texas*
512 457-9831 – direct line
ldiamond@r-alaw.com

June 14, 2012

Ms. Patricia Wheeler
Regional Inspector General for Audit Services
Office of Audit Services, Region VI
1100 Commerce Street, Room 632
Dallas, Texas 75242

Re: Response to draft report number A-06-11-00034

Dear Ms. Wheeler,

This firm represents the Economic Opportunities Development Corporation of Atascosa, Karnes, and Wilson Counties (hereinafter “EODC”). This letter is sent in response to your June 8, 2012 letter indicating that the Office of Inspector General had drafted a report for the EODC’s review. In that letter, you requested the EODC review the report, gather supporting documentation in response to the conclusions in the report, and additionally respond in writing to the report within five days. Despite the fact that the EODC received both the June 8, 2012 letter and draft report on June 11, 2012, the EODC has endeavored to gather the necessary information and respond within the time frame you required.

The EODC’s response to the report and supporting documentation is set out below. In overview, the EODC does not concur with any of the findings of the Office of Inspector General. Many of the OIG findings are not based on accurate recitation of the underlying facts, and some of the OIG’s findings do not reflect an understanding of the approvals received by OHS personnel. In conclusion, the EODC strongly rejects the recommendations of the OIG, especially as those recommendations relate to any allegation of fiscal impropriety.

OIG draft findings and EODC responses

OIG draft finding #1: The EODC claimed \$352,487 in construction costs that did not comply with the provisions approved in its applications for Federal construction assistance.

EODC executive response: The EODC does not concur. This OIG draft finding misstates the facts surrounding subsequent amendments to the EODC’s application, and further, the draft finding draws conclusions that are wholly inconsistent with the OHS grant of funds to the EODC. Finally, it is improper for the OIG to claim that it could not determine actual construction costs for the projects when documentation of the construction and costs was provided to the OIG auditors.

EODC rebuttal to draft finding #1: The OIG report correctly states that the OHS agreed to fund \$227,125 of the total estimated costs to buy land and construct a Head Start center, if

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EODC funded the remaining balance. However, the OIG incorrectly concludes that the construction of the facility occurred in violation of the terms of the Financial Assistance Award.

The original location for the construction of the first facility, as stated in the Financial Assistance Award dated 8/28/09 (attached as exhibit 1), was 201 North Esplanade, Karnes City, Texas. However, by the time the grant was awarded, the Esplanade site was no longer available. The EODC negotiated with the city of Karnes City for a fifty year lease at a cost of \$1.00 per year at an alternative site at 1025 East Main Street.

The OIG's stated methodology does not indicate that they contacted or interviewed OHS personnel; the facts of this dispute indicate that the OIG certainly did not interview the circumstances surrounding this construction project with local Program Specialist. If it had done so, the OIG would be aware of the EODC Director's actions in securing OHS approving both the alternative construction site and the lease terms for the property. The HHS Program Specialist in the Region VI Office at that time was Elida Sluss (now Elida Hatfield). When the long-term lease for the alternate location became available, the EODC Director contacted Ms. Sluss and informed her of the change prior to beginning construction at the new alternative location. Ms. Sluss approved the change of plans, including the long-term lease, and she did not indicate to the EODC that the change in location would violate the terms of the grant. Ms. Sluss also did not indicate that the EODC would need to get further approval from HHS or OHS. In addition, Ms. Sluss made an onsite visit during the construction phase, took pictures of the construction, and expressed approval of the project. All of Ms. Sluss' actions were consistent with her apparent authority to approve the new location and oversee the construction of the facility.

The EODC funded the remaining balance of the construction costs on the first facility, in part, by securing the very favorable \$1 per year, fifty year lease with the city of Karnes City at an alternative location. That creative, and permissible, agreement with the city was instrumental in permitting the EODC to cover the remaining construction costs for the first facility. However, the OIG report incorrectly states that EODC violated the terms of the Financial Assistance Award by failing to purchase land as specified in the FAA. Even if the EODC Director had not secured approval from the Region VI Office Program Specialist prior to construction (which he did), the failure to purchase land was not a violation of the FAA terms. The Financial Assistance Award dated 8/28/09 (attached to this letter as Exhibit 1) does not delineate how the FAA award money must be divided with regard to what amount is dedicated to purchase funds versus construction funds. In fact, the EODC estimate for the purchase of the land was only \$80,000 of the total \$908,500 project cost; therefore, even if all of the \$227,125 in grant funds had been expressly apportioned for the sole purpose of purchasing the property, the majority of the FAA grant would still be dedicated to the construction of a facility at the site. The OIG's conclusion that the OHS awarded \$80,000 solely for a land purchase is not supported by the express terms of the FAA. It is improper for the OIG to state that the EODC should be required to repay either \$80,000, or \$227,500, as an unallowable cost on the first facility just because the EODC was

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able to negotiate a reduction in the cost of a construction location that was approved and overseen by the appropriate Region Program Specialist.

With regard to the second facility, the OIG report correctly states that the OHS agreed to fund \$125,362 of the total estimated costs of purchasing land and building a Head Start Center, if EODC funded the remaining balance. However, the OIG again incorrectly concludes that the EODC incurred unallowable costs and violated the terms of the Financial Assistance Award.

The OIG's disapproval of the second facility appears to stem from the fact that the OIG chose to analyze the OHS share of costs on the second project solely by comparing the OHS' grant amount to the current Karnes County Central Appraisal District's appraised value for the property. The OIG admits that it did not compare the OHS grant and approved costs of construction to the actual cost of the land and construction; instead the OIG used the county appraised value. It is improper to compare the construction costs of a building in 2006-2007 to the 2011 county appraisal district value to determine if OHS funds were properly expended, especially given the volatile decline in real estate prices over the past few years. Moreover, OIG auditors clearly recognize that appraised values are NOT an appropriate measure of value, as stated in finding 14 of the audit. We agree with the OIG's assertion in finding 14 of the draft audit, page 12-13, that an appropriate measure of appraised value could have been determined by utilizing an independent licensed appraiser. If the OIG is going to reject appraisal district values as unreliable in one part of its audit report, it seems appropriate to reject appraisal district values for all space, land, and building valuations throughout the balance of the audit report. In addition, that ham-handed analysis was unnecessary. EODC personnel provided OIG auditors with access to documentation regarding the original 2007 appraised value of the property, original purchase price, and original construction costs.

Any assertion that the EODC did not fund its share of the land and building costs as set out in the OHS-approved applications is simply incorrect. The OIG's improper and incomplete methodology leads it to the erroneous conclusion that the EODC's construction was unallowable. The OIG's approach to its audit of these two construction projects failed to recognize substantial evidence supporting EODC's costs and the projects' present value, either of which are appropriate justification for the awarded funds. Because the OIG's audit was fundamentally flawed, its recommendation to require a refund is equally faulty.

OIG draft finding #2: The EODC claimed \$37,289 in expenses that were not reasonable or supported by source documentation.

EODC executive response: The EODC does not concur. This OIG draft finding simply ignores the documentation provided to OIG auditors.

EODC rebuttal to draft finding #2: During the audit, all expenditures for construction, maintenance and fuel were accompanied by source documentation. A large portion of these expenditures were made during a Karnes City Head Start construction project. Those payments

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were made to laborers, purchases of fuel for vehicles travelling to and from the construction site to deliver materials and transport workers.

In one example, the OIG asserts that \$17,982 in fuel purchases was unreasonable because “the Head Start director would have needed to drive more than 80,000 miles per year to accumulate [those] fuel charges.” That OIG statement blindly ignores the EODC Director and staff’s repeated corroboration that the fuel use reflected by that aggregate fuel usage was not just for the Head Start director, but for fuel charges incurred by many contractors and vehicles used in the Karnes City construction project. The OIG’s own auditors indicated that the Head Start director drove nearly 35,000 miles a year, which accounts for nearly half of the fuel charges that the OIG questioned. It is reasonable to assume that the remainder of those fuel charges was correctly associated with the large construction vehicles, fuel-inefficient trucks with trailers, and multiple trips for personnel/day laborers and construction supplies which were used in the construction project through receipts properly recorded and furnished to the OIG during the audit. It is unreasonable for the OIG to assume that receipts reflecting fuel charges to specific vehicles, incurred at the appropriate time frame for a large, ongoing construction project, and corroborated by both documents and EODC staff testimony, are somehow fraudulent or unsubstantiated costs.

EODC admits that some supporting documentation for salaries paid on construction costs was not immediately available to the auditors, but those documents in the form of sworn affidavits have now been forwarded to the OIG auditors for their review prior to the publication of the preliminary report. A review of those documents should necessitate the revision and removal of this draft finding as well as any recommendation based on this finding.

OIG draft finding #3: The EODC claimed \$309 for an ineligible salary payment that was not paid in accordance with Federal requirements and personnel policies.

EODC rebuttal to draft finding #3: The EODC does not concur. All salaries are documented by employee signed time cards, complete with sign-in/sign-out times; those wages are paid by EODC according to the Salary Schedule. No employees were paid “ineligible salaries”. EODC operates one Full Year/Full Day classroom which operates eleven (11) months. Apparently the OIG auditors misunderstood salary paid to Full Year/Full Day staff during June and August as being “holiday pay”. Full Year/Full Day Classroom Aides are permanent employees. According to EODC’s Personnel Policies they do receive benefits. The OIG auditors misunderstood the difference in a FY/FD Classroom Aide and Disabilities Aides who are temporary and do not receive benefits except those EODC is required to provide. The EODC will be happy to clarify the OIG’s misunderstanding of the facts and applicable policies in this finding.

OIG draft finding #4: The EODC claimed \$25,769 for an inadequately documented salary increase that was potentially unreasonable.

EODC rebuttal to draft finding #4: The EODC does not concur. The salary increase noted by the OIG auditor was presented to the Tri-County Board at the February 2009 meeting. The job description for the Fiscal Office manager had been revised to include many additional duties and

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responsibilities, not just acting as the Assistant Head Start Director if the director was unavailable. In fact, the duties and responsibilities for the Assistant Director include preparing agendas and materials for Tri-County Board and Head Start Policy Council meetings, acting as the contact person for the Administrative Office at all times that the Head Start Director is not immediately available, securing lease agreements for in-kind space, and obtaining estimates for minor repairs and maintenance projects. The additional responsibilities taken on by the Assistant Head Start Director did not apply only when the Director was unavailable, although the increase in salary was partially justified by the fact that the Director was consistently unavailable to handle these day-to-day responsibilities due to travel between the Head Start centers. Finally, the Tri-County Board approved the new salary schedule, which was an \$11,796 annual increase, not a \$25,769 increase.

OIG draft finding #5: The EODC did not pay salaries and payments for unused vacation in accordance with Federal requirements and personnel policies.

EODC rebuttal to draft finding #5: The EODC does not concur. As the OIG audit report correctly states, salaries and payments for unused vacation was paid in accordance with the EODC Personnel policies. EODC Personnel Policies Chapter VII—Employee Leave, Benefits and Expenses, Paragraph 4, page 17 and 18 provides that EODC employees working twelve months a year may sell all or part of their accrued unused vacation time back to the agency. However, no vacation time was ever sold before it was earned. OIG auditors are simply mistaken on this point.

For example, the OIG draft report states that the EODC prepaid the Head Start Director his last paycheck of FY 2010 over the 6 month period before it was earned and recorded as salary expenses. That is not true. The Head Start Director was paid his vacation for FY 2009-2010 on December 1, 2010, which was the last day the EODC Fiscal Year. All of his vacation days had been accrued as of the day he was paid for them.

OIG draft finding #6: The EODC did not segregate duties related to bank reconciliations and inventory procedures and ensure that only authorized personnel had access to the accounting system.

EODC rebuttal to draft finding #6: The EODC does not concur. Segregation of duties is maintained as much as possible with the small EODC administrative staff. The Fiscal manager reconciles the bank statements which are reviewed and approved by the Head Start Director. As the audit report correctly states, only authorized personnel have access to the accounting system: the Fiscal Manager, Accounting Clerk, and General Office Clerk for simple data entry matters. However, the OIG is incorrect in its statement that the Head Start Director could access the accounting system. Neither the Head Start Director nor any other Administrative Office personnel have access to the accounting system.

OIG draft finding #7: The EODC did not enter transactions into the system in a timely manner.

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EODC rebuttal to draft finding #7: The EODC does not concur. The OIG audit reports states that the EODC fiscal/office manager entered transactions manually into a ledger and then transferred the batch totals into EODC's automated accounting system at the end of each month. That is correct, but that is not a violation of the EODC's written procedures, which state that transactions should be identifiable and recorded in the accounting system in a timely manner. The manual ledger is the system. Apparently, the OIG does not dispute that transactions were entered manually into the ledger in a timely manner; however, that is all that the EODC's written procedures require. It appears that the OIG is requiring the EODC to enter individual transactions into the automated system daily; however, that is not required by any EODC policy or federal regulation. There is no basis for a pejorative finding based on these facts.

OIG draft finding #8: The EODC did not close out the automated accounting system at the end of the year.

EODC rebuttal to draft finding #8: The EODC does not concur. The OIG audit report states that the EODC did not close the accounts in the automated system at the end of the year, and that as a result, the EODC could not provide current and complete disclosure of financial results. This is incorrect in both the postulate and the conclusion. The OIG is well aware that the EODC recorded and concluded within 90 days of the end of the fiscal year, which is December 1. The accounts are then made available to the independent auditor. The accounts and records are all issued in compliance with the applicable regulations and in a condition conducive to the independent auditor's conducting a timely and accurate audit.

OIG draft finding #9: The EODC did not safeguard unused checks.

EODC rebuttal to draft finding #9: The EODC does not concur. The EODC keeps unused checks in a locked filing cabinet. The instance referred to in the audit report occurred when no one else was in the office except a general office clerk and one of the OIG auditors. The general office clerk stepped away from her desk for a moment, but remained in the same room, and left the blank checks face down on her desk. This was an isolated incident and not indicative of the daily process or procedure at the EODC office.

OIG draft finding #10: The EODC did not have written policies that address conflict of interest and procurement of consultants.

EODC rebuttal to draft finding #10: The EODC does not concur. The EODC policies that address conflicts of interest include: EODC Personnel Policies, Chapter VII, Section L, page 13; EODC By Laws, Article IV, Paragraph 2, page 3; and EODC Personnel Policies, Chapter XV, Paragraph E, page 32. In addition, EODC personnel Policies, Chapter II, Paragraph G, page 6 lists consultants as "those persons with whom EODC contracts to provide expertise in a particular area." The fact that consultants are included in EODC's "Classification of Employee" indicates that the policies allow the employment of consultants as needed.

OIG draft finding #11: The EODC did not maintain accurate property record cards on all assets.

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EODC rebuttal to draft finding #11: The EODC does not concur. Accurate property records are maintained on all assets. Property records provided by the independent auditor to the OIG auditor were inaccurate because they were passed to the OIG auditor from the previous independent auditor. The records maintained by the EODC's fiscal manager at the Administrative Office are complete and accurate. In fact, during the OIG audit, the fiscal manager and an OIG auditor reconciled the property records maintained by the fiscal office manager to the list provided by the independent auditor. All items were accounted for.

OIG draft finding #12: The EODC did not properly record the disposition of assets.

EODC rebuttal to draft finding #12: The EODC does not concur. Disposition of assets were recorded on the inventory cards appropriately and the proper entries were made to remove them from EODC's Fixed Assets as became unrepairable, unusable or when they were traded in or sold. This is an on-going process which is handled by the proper EODC administrative staff, but is not regularly updated by the EODC's independent auditor. During the OIG's audit, EODC staff became aware of the fact that the independent auditor's list of assets was inaccurate, even though EODC staff's list of assets was correct. EODC was unaware that the list in the independent auditor's possession contained inaccurate information until the OIG auditors requested that EODC obtain a list of fixed assets from the independent auditor. EODC pointed out the discrepancy to the OIG auditors and independently documented the accuracy and veracity of all assets listed in EODC's inventory through the EODC staff's records. Therefore, the OIG auditors' conclusion is incorrect, because the EODC properly recorded the disposition of assets; it was the independent auditor, and by extension the OIG who relied on the auditors' information, that held inaccurate property disposition records.

OIG draft finding #13: The EODC did not properly identify equipment.

EODC rebuttal to draft finding #13: The EODC does not concur. Each inventory listing has a serial number, or in the case a modular building, a description of the building and model number for identification purposes. The instance referred to in the OIG audit is an example: the OIG auditor went to a Head Start Center location and saw a modular building used for the center director's office. The building did not have an inventory tag or number in the record, so it was the OIG auditor's opinion that the building could not be identified. That conclusion by the OIG auditor is obviously incorrect.

OIG draft finding #14: The EODC did not properly value donated space, land, and buildings in claiming non-Federal share.

EODC rebuttal to draft finding #14: The EODC does not concur. The EODC attempted to obtain appraisals from independent appraisers for donated space, land and buildings on numerous occasions, as evidenced by letters to all licensed independent appraisers in the three county area. In most instances, no response was received from the appraisers, and those who did respond required high fees for conducting the appraisals. Ultimately, the value of the donated space, land, and buildings was based upon appraisals which were obtained from the County Appraisal Districts of Atascosa, Karnes, and Wilson.

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It is noteworthy that the OIG auditors should find that the use of appraisal district number is unsatisfactory, and furthermore, that the OIG would expressly state that the EODC should have engaged an independent appraiser to determine the non-Federal share of donated space. The OIG independent appraiser followed the same "appraisal district" methodology in support of its own conclusion in finding number 1 that EODC had incurred unallowable costs and violated the terms of a Financial Assistance Award.

Given the OIG's disapproval of "appraisal district" information for the purpose of determining value of space, land and buildings, it seems reasonable for the OIG to clarify when, if ever, such information would appropriately be used in an OIG audit scenario.

OIG draft finding #15: The EODC did not adequately document in-kind non-Federal share for volunteer services and ensure that they were allowable.

EODC rebuttal to draft finding #15: The EODC does not concur. In-kind/non-Federal share for volunteer services is adequately documented by the use of "in-Kind Time cards" which are signed by the volunteer and verified by the Center Directors' signatures. Administrative office personnel verify the value of the time donated, and it is recorded by the fiscal manager and entered in the accounting system on a monthly basis. EODC routinely generates non-Federal share services far in excess of the amounts required by the terms of the Head Start grant. The personnel who deal with the documentation of the non-Federal share at the center level are trained in recognizing what is an allowable in-kind contribution. In addition, the Administrative services are trained regarding allowable non-federal share contributions and are diligent in their examination of the documentation. Any assertion that EODC in-kind non-Federal share services are actually inadequate is preposterous; the inclusion of a handful of non-complaint timecards in the documentation should be considered a *de minimus* error, not a basis for sanctions.

In conclusion, EODC stands ready to assure OHS that it is properly fulfilling the terms of its grant and complying with Federal requirements for operation. If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jason Ray". To the right of the signature, there is a small, faint rectangular stamp with the word "Signature" inside.

/Jason Ray/
Attorney for EODC

cc: EODC of AKW

APPENDIX B: OFFICE OF HEAD START COMMENTS

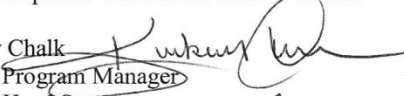


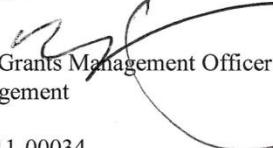
ADMINISTRATION FOR
CHILDREN & FAMILIES

Office of Head Start, 1301 Young Street, Room 937, Dallas, TX 75202 www.eclkc.ohs.acf.hhs.gov

Date: August 24, 2012

To: Patricia Wheeler
Regional Inspector General for Audit Services

From: Kimberly Chalk 
Regional Program Manager
Office of Head Start

Ray Bishop, Regional Grants Management Officer
Office of Grants Management 

Subject: Report Number A-06-11-00034

The Office of Inspector General (OIG), Office of Audit Services, provided the draft audit report for Economic Opportunities Development Corporation of Atascosa, Karnes, and Wilson Counties (EODC), Report Number A-06-11-00034 to the Department of Health and Human Services (DHHS), Administration for Children and Families (ACF), Office of Head Start (OHS) for comments on August 1, 2012. The audit report examined expenditures under grants awarded to EODC, specifically Grant Numbers 06CH5071 and 06SE5071. The six recommendations identified in the draft audit report are addressed below.

Recommendation 1:

The draft report recommends OHS require EODC to refund \$372,081 in unallowable costs related to its Head Start grant.

The Office of Head Start (OHS) and the Office of Grants Management (OGM) concur with this recommendation if it is determined EODC failed to utilize \$352,487 for construction as intended.

OHS and OGM concur EODC claimed \$19,285 for fuel expenditures that were not reasonable.

OHS and OGM concur EODC claimed \$309 for an ineligible salary payment that was not paid in accordance with Federal requirements and personnel policies.

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Recommendation 2:

The draft report recommends OHS work with EODC to determine whether the inadequately documented salary increase totaling \$25,769 was reasonable and refund any portion determined to be unreasonable.

OHS and OGM concur with this recommendation.

Recommendation 3:

The draft report recommends OHS work with EODC to determine whether expenditures for construction, maintenance, and repair payments totaling \$18,004 were supported by adequate documentation.

OHS and OGM concur with this recommendation.

Recommendation 4:

The draft report recommends OHS impose special award conditions on EODC to ensure that its financial system provides accurate, current, and complete disclosure of financial results and records that identify the source and application of funds for HHS-sponsored activities.

OHS and OGM concur with this recommendation and will arrange for provision of training and technical assistance resources upon issuance of the final report.

Recommendation 5:

The draft report recommends OHS impose special award conditions on EODC to ensure that it has effective control over and accountability for all funds, property, and other assets and that it adequately safeguards all assets and ensures they are used solely for authorized purposes.

OHS and OGM concur with this recommendation and will arrange for provision of training and technical assistance resources upon issuance of the final report.

OHS and OGM concur with this recommendation with the understanding additional field work would be required to make determinations of any potential disallowed costs.

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Recommendation 6:

The draft report recommends OHS work with EODC to ensure the following:

- Claims Head Start expenditures that are allowable,
- Complies with the approved provisions in applications for Federal Assistance for construction,
- Monitors the use of credit cards for fuel purchases and increases oversight of credit card use,
- Adequately documents salary increases and follows personnel policies when compensating employees,
- Follows Federal requirements in paying salaries and vacation pay,
- Segregates duties so that individuals who maintain property records are not the same individuals who perform the physical inventory,
- Develops written policies and procedures that adequately address conflicts of interest and written policies that address the procurement of consultants,
- Properly values non-Federal share for donated space, land, and buildings, and
- Adequately documents allowable in-kind non-Federal share for volunteer services

OHS and OGM concur with this recommendation and will arrange for provision of training and technical assistance resources after issuance of the final OIG Report.

Thank you for the opportunity to comment on the draft report.