DEPARTMENT OF HEALTH & HUMAN SERVICES **Office of Inspector General**

Washington, D.C. 20201

February 25, 2010

TO: Yvette Sanchez Fuentes
Director, Office of Head Start
Administration for Children and Families

FROM: /Lori S. Pilcher/
Assistant Inspector General for Grants, Internal Activities,
and Information Technology Audits

SUBJECT: Results of Limited Scope Review at Metropolitan Child Services, Inc.'s Head Start Program (A-02-09-02016)

The attached final report provides the results of our limited scope review of Metropolitan Child Services, Inc.'s (Metropolitan's) capacity to manage and account for Federal funds and operate its Head Start program in accordance with Federal regulations. This review was requested by the Administration for Children and Families (ACF), Office of Head Start as part of its overall assessment of Head Start grantees that have applied for additional funding under the Recovery Act.

The Recovery Act was signed into law by President Obama on February 17, 2009. The Recovery Act includes measures to modernize our nation's infrastructure, enhance energy independence, expand educational opportunities, preserve and improve affordable health care, provide tax relief, and protect those in greatest need.

At the President's direction, Federal agencies are taking critical steps to carry out the Recovery Act effectively. All Federal agencies and departments receiving Recovery Act funds must maintain strong internal controls and implement oversight mechanisms and other approaches to meet the accountability objectives of the Recovery Act.

Metropolitan is a non-profit agency which operates a Head Start program that provides education, health, and social services to approximately 50 low-income pre-school children and their families at one location in Brooklyn, New York. Metropolitan is 1 of 10 schools throughout New York City operated by MetSchools, Inc. (MetSchools), a for-profit corporation based in New York, New York. Metropolitan shares building space, teaching staff and administrative staff with another MetSchools institution—the Vernon Avenue Children's School, LLC (Vernon), a for-profit entity. Payments for expenditures incurred by Metropolitan and Vernon are centralized and administered by MetSchools.

The objectives of our limited scope review were to determine whether: (1) Metropolitan used Head Start funds to pay only allowable Head Start expenditures resulting from obligations incurred during the grant period, (2) Metropolitan properly allocated its shared costs to all benefitting programs, (3) Metropolitan accurately reported expenditures to ACF, and (4) Metropolitan complied with Federal regulations related to program governance.

Head Start funds were improperly transferred to pay non-Head Start daycare and food program expenditures incurred by Metropolitan as well as non-Head Start expenditures incurred by Vernon. In addition, Metropolitan charged unallowable expenditures to its Head Start grant, did not properly allocate shared costs to all benefitting programs, and did not accurately report the financial status of its Head Start grant to ACF. Lastly, Metropolitan complied with Federal regulations related to program governance.

In written comments on our draft report, Metropolitan concurred with our findings and described corrective actions it had taken or planned to take. Metropolitan also clarified its practice of transferring Head Start funds to pay non-Head Start expenditures. We revised our report to reflect this clarification.

In determining whether Metropolitan should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing Metropolitan's capacity to manage and account for Federal funds.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that Office of Inspector General (OIG) post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://oig.hhs.gov.

Please send us your final management decision, including any action plan, as appropriate, within 60 days. If you have any questions or comments about this report, please do not hesitate to contact me at (202) 619-1175 or through email at Lori.Pilcher@oig.hhs.gov. Please refer to report number A-02-09-02016 in all correspondence.

Attachment

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

RESULTS OF LIMITED SCOPE REVIEW AT METROPOLITAN CHILD SERVICES, INC.'S HEAD START PROGRAM

Daniel R. Levinson
Inspector General

February 2010
A-02-09-02016

Office of Inspector General

http://oig.hhs.gov

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

Office of Audit Services

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

Office of Evaluation and Inspections

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

Office of Investigations

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at http://oig.hhs.gov

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Pursuant to Public Law 110-134, Improving Head Start for School Readiness Act of 2007, Head Start is a national program that promotes school readiness by enhancing the social and cognitive development of children through the provision of educational, health, nutritional, social and other services to enrolled children and families. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF) administers the Head Start program. The Head Start program provides grants to local public and private non-profit and for-profit agencies to provide comprehensive child development services to economically disadvantaged children and families.

Under the American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, ACF received $1 billion, including nearly $354 million to help improve staff compensation and training, upgrade Head Start centers and classrooms, increase hours of operation and enhance transportation services. An additional $356 million was allocated to award all Head Start grantees a nearly five percent cost-of-living increase and bolster training and technical assistance services.

Metropolitan Child Services, Inc. (Metropolitan), a non-profit agency, operates a Head Start program that provides education, health, and social services to approximately 50 low-income pre-school children and their families at one location in Brooklyn, New York. It also operates daycare and food programs. Metropolitan is 1 of 10 schools throughout New York City operated by MetSchools, Inc. (MetSchools), a for-profit corporation based in New York, New York.

During grant years (GYs) 2008 and 2009 (February 1, 2007, through January 31, 2009), ACF directly provided Head Start funds to Metropolitan totaling $527,547 and $518,547, respectively. In addition, Metropolitan's Head Start program received Recovery Act grant funding for GY 2010 totaling $28,660 for cost-of-living increases and quality improvement.

Metropolitan shares building space, teaching staff, and administrative staff with another MetSchools institution—the Vernon Avenue Children's School, LLC (Vernon), a for-profit entity. Payments for expenditures incurred by Metropolitan and Vernon are centralized and administered by MetSchools.

OBJECTIVES

The objectives of our limited scope review were to determine whether: (1) Metropolitan used Head Start funds to pay only allowable Head Start expenditures resulting from obligations incurred during the grant period, (2) Metropolitan properly allocated its shared costs to all benefitting programs, (3) Metropolitan accurately reported expenditures to ACF, and (4) Metropolitan complied with Federal regulations related to program governance.

SUMMARY OF FINDINGS

Head Start funds were improperly transferred to pay non-Head Start daycare and food program expenditures incurred by Metropolitan as well as non-Head Start expenditures incurred by Vernon. In addition, Metropolitan charged unallowable expenditures to its Head Start grant, did not properly allocate shared costs to all benefitting programs, and did not accurately report the financial status of its Head Start grant to ACF. Lastly, Metropolitan complied with Federal regulations related to program governance.

RECOMMENDATION

In determining whether Metropolitan should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing Metropolitan's capacity to manage and account for Federal funds.

METROPOLITAN CHILD SERVICES, INC., COMMENTS

In written comments on our draft report, Metropolitan concurred with our findings and described corrective actions it had taken or planned to take. Metropolitan also clarified its practice of transferring Head Start funds to pay non-Head Start expenditures. We revised our report to reflect this clarification. Metropolitan's comments are included in their entirety as the appendix.

TABLE OF CONTENTS

INTRODUCTION

BACKGROUND

Head Start Program

Pursuant to Public Law 110-134, Improving Head Start for School Readiness Act of 2007, Head Start is a national program that promotes school readiness by enhancing the social and cognitive development of children through the provision of educational, health, nutritional, social and other services to enrolled children and families. Within the U.S. Department of Health and Human Services, the Administration for Children and Families (ACF) administers the Head Start program. On a quarterly basis, Head Start grantees are required to submit Financial Status Reports (FSRs) to ACF.

The Head Start program provides grants to local public and private non-profit and for-profit agencies to provide comprehensive child development services to economically disadvantaged children and families, with a special focus on helping preschoolers develop the early reading and math skills needed to be successful in school. Head Start programs engage parents in their children's learning and emphasize parental involvement in the administration of local Head Start programs.

Under the American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act), enacted February 17, 2009, ACF received $1 billion, including nearly $354 million to help improve staff compensation and training, upgrade Head Start centers and classrooms, increase hours of operation and enhance transportation services. An additional $356 million was allocated to award all Head Start grantees a nearly five percent cost-of-living increase and bolster training and technical assistance services.

Metropolitan Child Services, Inc.

Metropolitan Child Services, Inc. (Metropolitan), a non-profit agency, operates a Head Start program that provides education, health, and social services to approximately 50 low-income pre-school children and their families at one location in Brooklyn, New York. It also operates daycare[1] and food programs.[2] Metropolitan is 1 of 10 schools throughout New York City operated by MetSchools, Inc. (MetSchools), a for-profit corporation based in New York, New York.[3]

During grant years (GYs) 2008 and 2009 (February 1, 2007, through January 31, 2009) ACF directly provided Head Start funds to Metropolitan totaling $527,547 and $518,547, respectively.

---

[1]Funding for Metropolitan's daycare program was provided by ACF under the Child Care and Development Block Grant and by the New York City Administration for Children's Services.

[2]Funding for Metropolitan's food program was provided by the U.S. Department of Agriculture under the Child and Adult Care Food Program.

[3]Metropolitan's executive director is the sole owner of MetSchools.

In addition, Metropolitan's Head Start program received Recovery Act grant funding for GY 2010 totaling $28,660 for cost-of-living increases and quality improvement.

Metropolitan shares building space, teaching staff, and administrative staff with another MetSchools institution—the Vernon Avenue Childrens School (Vernon), a for-profit entity. Payments for expenditures incurred by Metropolitan and Vernon are centralized and administered by MetSchools.

Requirements for Federal Grantees

Pursuant to 45 CFR § 74.28, only allowable costs incurred for the benefit of the grant during the funding period may be charged to the grant award. In addition, pursuant to 45 CFR § 74.21, grantees must maintain written procedures for allocating shared costs to all benefitting programs. Grantees are also required to maintain financial systems that provide for accurate and complete reporting of grant related financial data. Further, pursuant to 45 CFR § 1301.30, grantees are required to conduct the Head Start program in an effective and efficient manner, free of political bias or family favoritism.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our limited scope review were to determine whether: (1) Metropolitan used Head Start funds to pay only allowable Head Start expenditures resulting from obligations incurred during the grant period, (2) Metropolitan properly allocated its shared costs to all benefitting programs, (3) Metropolitan accurately reported expenditures to ACF, and (4) Metropolitan complied with Federal regulations related to program governance.

Scope

This review was performed based upon a limited scope request from ACF, dated May 5, 2009. Therefore, we did not perform an overall assessment of Metropolitan's internal control structure. Rather, we reviewed only the internal controls that pertained directly to our objectives. Our review period was GYs 2008 and 2009.

We performed our fieldwork at MetSchools' administrative office in New York, New York, during June and July 2009.

Methodology

To accomplish our objectives, we:

- reviewed relevant Federal laws, regulations, and guidance;

- reviewed Metropolitan's fiscal procedures;

- reviewed Metropolitan’s cost allocation methodology;

- compared Head Start grant award expenditures recorded on Metropolitan’s general ledger to funds drawn down from the Department of Health and Human Services’ electronic payment system and to expenditures reported on Metropolitan’s final FSRs;

- reviewed minutes of Metropolitan’s Governing Board meetings; and

- reviewed Metropolitan’s payroll registers and general ledgers to determine if Metropolitan Governing Board members were employed by Metropolitan or received compensation for serving on the Board.

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

FINDINGS AND RECOMMENDATION

Head Start funds were improperly transferred to pay non-Head Start daycare and food program expenditures incurred by Metropolitan as well as non-Head Start expenditures incurred by Vernon. In addition, Metropolitan charged unallowable expenditures to its Head Start grant, did not properly allocate shared costs to all benefitting programs, and did not accurately report the financial status of its Head Start grant to ACF. Lastly, Metropolitan complied with Federal regulations related to program governance.

RELATED PARTY EXPENDITURES

Pursuant to ACF Information Memorandum ACYF-IM-HS-01-06, “Financial Management Issues in Head Start Programs Utilizing Other Sources of Funding,” issued March 8, 2001, “Head Start grantees may not transfer, even on a temporary basis, funds from Head Start to compensate for delayed or late payment from other funding sources unrelated to the Head Start Act and for costs that are not allowable in Head Start.” In addition, pursuant to 45 CFR § 74.28, only allowable costs incurred for the benefit of the grant during the funding period may be charged to the grant award.

Contrary to Federal regulations and ACF program guidance, Head Start funds were periodically transferred to pay non-Head Start daycare and food program expenditures incurred by Metropolitan as well as non-Head Start expenditures incurred by Vernon. Conversely, non-Head Start funds were periodically transferred from Metropolitan’s daycare and food programs as well as from Vernon to pay Head Start expenditures. This occurred because funds were comingled and expenditures were paid with available funding, regardless of the funding source. Non-Head Start daycare, food program, and Vernon expenditures paid with Head Start funds were recorded in Metropolitan’s general ledger as an intercompany receivable whereas Head Start expenditures paid with non-Head Start funds were recorded in Metropolitan's general ledger as an intercompany payable.

As of January 31, 2009, Metropolitan's general ledger showed an intercompany receivable balance of $332,054. However, Metropolitan was unable to segregate the balance owed to its Head Start program by source (i.e., Metropolitan's daycare and food programs and Vernon).

UNALLOWABLE EXPENDITURES

Tuition Reimbursement

Pursuant to 45 CFR § 74.28, grant funds may only be used in the period for which the funds were awarded. Grantees that have an unobligated balance must request approval from ACF to carry the associated funds over for use in the following grant year.[4]

Metropolitan received GY 2008 funding totaling $9,000 to reimburse staff for college tuition incurred for coursework taken to meet New York State-mandated certification requirements. However, contrary to Federal regulations, Metropolitan did not use the monies for Metropolitan's intended purpose in GY 2008. Instead, Metropolitan expended the monies over two subsequent GYs-$3,280 in GY 2009 for general expenditures and $5,720 in GY 2010 for reimbursement of staff tuition costs.

Late Fees

Pursuant to OMB Circular A-122, Cost Principles for Non-Profit Organizations, App. B, § 16 (2 CFR pt. 230, App. B, § 16), costs for fines and penalties are unallowable. However, during our audit period, Metropolitan improperly charged the Head Start grant for late fees, totaling $410, related to nonpayment of prior period copier equipment rental expenditures.

EXPENDITURES IMPROPERLY ALLOCATED

Pursuant to 45 CFR § 74.21(b)(6), grantees must maintain written procedures for allocating shared costs to all benefitting programs. In addition, OMB Circular A-122, Cost Principles for Non-Profit Organizations, App. B, § 8.m(2) (2 CFR pt. 230, App. B, § 8.m(2)) requires that charges to awards for salaries be supported by time and effort reports reflecting the actual activity for each employee.

Corporate Administrative Costs

During our audit period, Metropolitan improperly allocated costs for some MetSchools administrative staff salaries and related fringe benefits, totaling approximately $161,175, to the Head Start program. This occurred because Metropolitan's cost allocation methodology did not contain provisions for allocating these costs to Metropolitan's other benefitting programs (i.e., its daycare and food programs), Vernon, or other MetSchools sites even though the administrative

[4]Unobligated balances represent grant award funding for which no expenditures have been incurred. If ACF approves a grantee's request to carry funds over to the following grant year, it issues an amended grant award.

staff served those programs in a similar capacity. Moreover, contrary to Federal regulations, Metropolitan did not support these allocated costs with a time and effort report. As a result, Metropolitan did not ensure that it properly allocated its shared costs to all benefitting programs,

Facilities and Administrative Costs

Metropolitan used an improper methodology to allocate facilities and administrative costs (e.g., supplies and miscellaneous office expenses) during GY 2008 to its benefitting Head Start, daycare, and food programs, and to Vernon. Specifically, Metropolitan allocated these costs by using a weighted average of children served in the classroom—a method that resulted in a disproportionately larger share of the costs being allocated to Head Start.[5] Metropolitan officials stated that they recognized that this methodology should not have been used to calculate facilities and administrative costs and, for GY 2009, revised its methodology to remove the weighted average component. We determined that the revised methodology is reasonable. We applied the revised methodology to calculate Metropolitan's GY 2008 facilities and administrative costs related to Head Start and determined that Metropolitan improperly charged $5,016 to the Head Start program.

Professional Fees

During our audit period, Metropolitan incurred costs for professional accounting and bookkeeping services totaling approximately $94,927. These costs benefitted Metropolitan's Head Start, daycare, and food programs. However, Metropolitan allocated these costs only to the Head Start program because its cost allocation methodology contained no provisions for allocating the costs to its benefitting daycare and food programs.

EXPENDITURES IMPROPERLY REPORTED

Pursuant to 45 CFR § 74.21(b)(1), Federal grantees are required to maintain financial systems that provide for accurate and complete reporting of grant-related financial data. In addition, as a condition for receiving Head Start funds, grantees such as Metropolitan are required to provide ACF with a final FSR detailing expenditures paid during the grant period as well as any unobligated balances remaining at the end of the grant period.

Contrary to Federal requirements, Metropolitan did not report only expenditures incurred and paid during GY 2008 on its final FSR. As detailed earlier, Metropolitan received GY 2008 funding totaling $9,000 to reimburse staff for tuition related to college coursework taken to meet New York State-mandated certification requirements. Metropolitan requested drawdowns for these expenses totaling $9,000 in GY 2008. However, the expenses were not incurred until GY 2009, when Metropolitan's staff completed the coursework. Therefore, on its GY 2008 final FSR submitted to ACF, Metropolitan should have reported the unobligated $9,000 balance.

[5]The weighted average cost allocation methodology was developed for Metropolitan's salaried classroom professional costs. According to Metropolitan officials, the methodology was weighted more for Head Start program enrollees than non-Head Start program enrollees because children enrolled in the Head Start program required more staff time than children enrolled in other programs. However, the methodology is not appropriate for allocating facilities and administrative costs because these costs are not related to classroom activities.

However, Metropolitan reported the $9,000 as expended. As a result, Metropolitan's GY 2008 final FSR submitted to ACF did not accurately reflect the true financial status of Metropolitan's Head Start grant.

PROGRAM GOVERNANCE

Metropolitan complied with Federal regulations related to program governance. Specifically, no Governing Board members were employed by Metropolitan and no Board member received compensation for serving on the Board.

RECOMMENDATION

In determining whether Metropolitan should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing Metropolitan's capacity to manage and account for Federal funds.

METROPOLITAN CHILD SERVICES, INC., COMMENTS

In written comments on our draft report, Metropolitan concurred with our findings and described corrective actions it had taken or planned to take. Metropolitan also clarified its practice of transferring Head Start funds to pay non-Head Start expenditures. We revised our report to reflect this clarification. Metropolitan's comments are included in their entirety as the appendix.

APPENDIX

APPENDIX: METROPOLITAN CHILD SERVICES, INC., COMMENTS

METROPOLITAN
CHILD SERVICES INC.
A NOT FOR PROFIT PROVIDER OF SERVICES FOR YOUTH and CHILDREN

October 23, 2009

Mr. James P. Edert
Regional Inspector General for Audit Services
Department of Health & Human Services
Region II
Jacob Javits Federal Building
26 Federal Plaza – Room 3900
New York, NY 10278

Re: Report Number: A-02-09-02016 – Management Responses

Dear Mr. Edert:

Per your letter and draft report submission (Report Number: A-02-09-02016) to Metropolitan Child Services, Inc. (MCS) dated September 25, 2009, please find attached our responses to the Recommendations seen in this report. The format of our response will be a complete reproduction of your Finding and Recommendation, and then our management response.

If you also have any other questions or issues, regarding our response, please do not hesitate to contact me.

Kind regards,

Kevin McCarthy

Kevin McCarthy
CFO, MetSchools, Inc.

Cc; Mark Henkin
Michael Koffler
Margot Sigmone
John Madigan

Report Section - SUMMARY OF FINDINGS

MetSchools improperly borrowed Metropolitan's Head Start funds to pay non-Head Start expenditures incurred by Metropolitan and Vernon. In addition, Metropolitan charged unallowable expenditures to its Head Start grant, did not properly allocate shared costs to all benefitting programs, and did not accurately report the financial status of its Head Start grant to ACF. Lastly, Metropolitan complied with Federal regulations related to program governance.

Management Response – Management agrees with this summary of findings, but does note that its historical basis practice was to co-mingle the funds of the different programs operated specifically at this site by the Vernon and MCS entities – which it acknowledges must be changed. It is also noted that MetSchools Inc. (the parent entity of Vernon) did not borrow funds from MCS – rather, Vernon, the for-profit entity also operating at the 386 Vernon Avenue location borrowed/shared funds with the 5 different programs being offered at this site. Management has already taken corrective action to address these different issues – including specifically the need to segregate and maintain the funding for the different programs being at operated at this site. A new, updated allocation methodology was created successfully for use during FY 2009 (see the FY 2009 A-133 single audit report for MCS) as well. In addition the CFO will work with the Program Director and the site's Accountant to be sure that accurate reporting of its Head Start grant to ACF is ensured in future.

Report Section - FINDINGS AND RECOMMENDATION

MetSchools improperly borrowed Metropolitan's Head Start funds to pay non-Head Start expenditures incurred by Metropolitan and Vernon . In addition, Metropolitan charged unallowable expenditures to its Head Start grant, did not properly allocate shared costs to all benefitting programs, and did not accurately report the financial status of its Head Start grant to ACF. Lastly, Metropolitan complied with Federal regulations related to program governance.

Management Response – Management agrees with this summary of findings, but does note that its historical basis practice was to co-mingle the funds of the different programs operated specifically at this site by the Vernon and MCS entities – which it acknowledges must be changed. It is also noted that MetSchools Inc. (the parent entity of Vernon) did not borrow funds from MCS – rather, Vernon, the for-profit entity also operating at the 386 Vernon Avenue location borrowed/shared funds with the 5 different programs being offered at this site. Management has already taken corrective action to address these different issues – including specifically the need to segregate and maintain the funding for the different programs being at operated at this site. A new, updated allocation methodology was created successfully for use during FY 2009 (see the FY 2009 A-133 single audit report for MCS) as well. In addition the CFO will work with the Program Director and the site's Accountant to be sure that accurate reporting of its Head Start grant to ACF is ensured in future.

RELATED PARTY EXPENDITURES

Pursuant to 45 CFR § 74.28, only allowable costs incurred for the benefit of the grant during the funding period may be charged to the grant award. Further, ACF Information Memorandum ACYF-IM-HS-01-06, "Financial Management Issues in Head Start Programs Utilizing Other Sources of Funding," issued March 8, 2001, states, "Head Start grantees may not transfer, even on a temporary basis, funds from Head Start to compensate for delayed or late payment from other funding sources unrelated to the Head Start Act and for costs that are not allowable in Head Start."

Contrary to Federal regulations and ACF program guidance, MetSchools periodically borrowed Metropolitan's Head Start funds to pay non-Head Start expenditures incurred by Metropolitan and Vernon. Conversely, MetSchools periodically borrowed Vernon funds to pay Head Start and other program expenditures incurred by Metropolitan. This occurred because MetSchools comingled Metropolitan and Vernon funds and paid either school's expenses with available funding, regardless of the funding source. Non-Head Start expenditures paid with Metropolitan funds were recorded in Metropolitan's general ledger as an intercompany receivable whereas Metropolitan expenditures paid with Vernon funds were recorded in Metropolitan's general ledger as an intercompany payable.

Management Response – Management agrees that for GY 2008 and GY 2009 that its historical operating practice was to co-mingle site program funds to pay the expenses of the different programs at the site. It recognizes the need to segregate and maintain these different program funds in future, and has already taken action to address this issue – through the creation of a separate Metropolitan operating account (see FY 2009 A-133 single audit report for Metropolitan). Management also notes – per this A-133 report – that the balance owed to Metropolitan by Vernon has been reduced to under $100k, and that this balance is projected to be completely eliminated during FY 2010. It is also noted again that MetSchools (the parent entity of Vernon) did not borrow funds from Metropolitan – rather Vernon, the for-profit entity operating at this site borrowed/shared funds with the different Metropolitan programs at this site.

UNALLOWABLE EXPENDITURES Tuition

Reimbursement

Pursuant to 45 CFR § 74.28, grant funds may only be used in the period for which the funds were awarded. Grantees that have an unobligated balance must request approval from ACF to carry the associated funds over for use in the following grant year.[4]

Metropolitan received GY 2008 funding totaling $9,000 to reimburse staff for college tuition incurred for coursework taken to meet New York State-mandated certification requirements. However, contrary to Federal regulations, Metropolitan did not use the monies for Metropolitan's intended purpose in GY 2008. Instead, Metropolitan expended the monies over two subsequent GYs-$3,280 in GY 2009 for general expenditures and $5,720 in GY 2010 for reimbursement of staff tuition costs.

Management Response – Management agrees with this finding, and has already taken corrective action. The CFO, working with site's Accountant and its Program Director will ensure that obligated funds are spent timely.

Late Fees

Pursuant to OMB Circular A-122, Cost Principles for Non-Profit Organizations, App. B, § 16 (2 CFR pt. 230, App. B, § 16), costs for fines and penalties are unallowable. However, during our audit period, Metropolitan improperly charged the Head Start grant for late fees, totaling $410, related to nonpayment of prior period copier equipment rental expenditures.

Management Response – Management agrees with this finding, and the CFO working with the site's Accountant will ensure that this error does not occur again.

EXPENDITURES IMPROPERLY ALLOCATED

Pursuant to 45 CFR § 74.21(b)(6), grantees must maintain written procedures for allocating shared costs to all benefitting programs. In addition, OMB Circular A-122, Cost Principles for Non-Profit Organizations, App. B, § 8.m(2) (2 CFR pt. 230, App. B, § 8.m(2)) requires that charges to awards for salaries be supported by time and effort reports reflecting the actual activity for each employee.

Corporate Administrative Costs

During our audit period, Metropolitan improperly allocated costs for some MetroSchools administrative staff salaries and related fringe benefits, totaling approximately $161,175, to the Head Start program. This occurred because Metropolitan's cost allocation methodology did not contain provisions for allocating these costs to Metropolitan's other benefitting programs (i.e., its daycare and food programs), Vernon, or other MetSchools sites even though the administrative staff served those programs in a similar capacity. Moreover, contrary to Federal regulations, Metropolitan did not support these allocated costs with a time and effort report. As a result, Metropolitan did not ensure that it properly allocated its shared costs to all benefitting programs.

Management Response – During this 2 year audit period, 100% of site-specific corporate administrative staff salaries and related fringe benefits, (totaling approximately $161,175 for the site) were allocated to both the Vernon (25%) and Metropolitan (75%) operations. Costs, within the Metropolitan entity were then allocated - for example during FY 2009, more than 1/2 of these costs allocated to Metropolitan were then charged to Head Start – an allocation made in accordance with Metropolitan's written allocation methodology. However these allocated, site-specific salary costs were not supported by a time and effort report reflecting the actual activity for each staff member. Consequently, Management agrees that it could not ensure a proper allocation of site-specific corporate administrative costs across the Metropolitan entity, and thus the Head Start program . Management recognizes the importance of having specific time and effort reports for these administrative positions – and these reports have already been created for FY 2010. This will then allow a more accurate allocation of these costs to the different programs at the site.

Facilities and Administrative Costs

Metropolitan used an improper methodology to allocate facilities and administrative costs (e.g., supplies and miscellaneous office expenses) during GY 2008 to its benefitting Head Start, daycare, and food programs, and to Vernon. Specifically, Metropolitan allocated these costs by using a weighted average of children served in the classroom—a method that resulted in a disproportionately larger share of the costs being allocated to Head Start.[5] Metropolitan officials stated that they recognized that this methodology should not have been used to calculate facilities and administrative costs and, for GY 2009, revised its methodology to remove the weighted average component. We determined that the revised methodology is reasonable. We applied the revised methodology to calculate Metropolitan's GY 2008 facilities and administrative costs related to Head Start and determined that Metropolitan improperly charged $5,016 to the Head Start program.

<u>Management Response</u> – Management agrees with this finding, and it has already taken the corrective action noted above.

Professional Fees

During our audit period, Metropolitan incurred costs for professional accounting and bookkeeping services totaling approximately $94,927. These costs benefitted Metropolitan's Head Start, daycare, and food programs. However, Metropolitan allocated these costs only to the Head Start program because its cost allocation methodology contained no provisions for allocating the costs to its benefitting daycare and food programs.

<u>Management Response</u> – Management agrees with this finding. It is noted that this finding has already been corrected as part of our FY 2009 A-133 audit report .

EXPENDITURES IMPROPERLY REPORTED

Pursuant to 45 CFR § 74.21(b)(1), Federal grantees are required to maintain financial systems that provide for accurate and complete reporting of grant-related financial data. In addition, as a condition for receiving Head Start funds, grantees such as Metropolitan are required to provide ACF with a final FSR detailing expenditures paid during the grant period as well as any unobligated balances remaining at the end of the grant period.

Contrary to Federal requirements, Metropolitan did not report only expenditures incurred and paid during GY 2008 on its final FSR. As detailed earlier, Metropolitan received GY 2008 funding totaling $9,000 to reimburse staff for tuition related to college coursework taken to meet New York State-mandated certification requirements. Metropolitan requested drawdowns for these expenses totaling $9,000 in GY 2008. However, the expenses were not incurred until GY 2009, when Metropolitan's staff completed the coursework. Therefore, on its GY 2008 final FSR submitted to ACF, Metropolitan should have reported the unobligated $9,000 balance. However, Metropolitan reported the $9,000 as expended. As a result, Metropolitan's GY 2008 final FSR submitted to ACF did not accurately reflect the true financial status of Metropolitan's Head Start grant.

Management Response – Management agrees with this finding, and has already taken action to ensure that this type of issue does not occur again. The CFO will work with the Program Director and the site's Accountant to ensure that accurate reporting of its Head Start grant to ACF occurs, and in particular that obligated funds are spent timely.