DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Washington, D.C. 20201

January 7, 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 FiveCAP, Inc., for the Period November 1, 2005, Through July 31, 2009 (A-05-09-00089)

The attached final report provides the results of our limited scope review at FiveCAP, Inc., for the period November 1, 2005, through July 31, 2009. 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.

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.

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 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 activities.

The objectives of our limited scope review were to determine whether FiveCAP addressed past deficiencies, resolved issues regarding financial viability and
claims for vacation costs, and if it has the capacity to manage and account for Federal funds.

FiveCAP's overall financial position remains an area of concern. Based on its current financial condition, FiveCAP can not ensure the continuing viability of the organization unless it restructures its debt or receives additional funding. In addition, FiveCAP may have claimed unreasonable compensation costs from the Head Start program for its Executive Director's vacation pay in lieu of time off.

In written comments on our draft report, FiveCAP stated that it disputes the finding that it is not financially viable and believes the finding should be removed from the final report. FiveCAP disagrees with the methods used to assess financial viability and OIG's reporting of the short term liquidity analysis. FiveCAP disputed the finding that $32,765 for vacation compensation for the Executive Director from the period of November 1, 2005, through July 31, 2009 was unallowable. FiveCAP stated that the Board of Directors determined that the amounts of vacation days and pay were appropriate under the circumstances.

After reviewing FiveCAP's comments, we maintain that our findings regarding its financial viability remain valid. We did amend our finding on vacation compensation to state that FiveCAP may have claimed unreasonable vacation compensation in lieu of vacation time for the Executive Director. We are concerned both with the amount of compensation paid in lieu of vacation time throughout our review period and in FY 2008 the amount of vacation time provided to the Executive Director.

In determining whether FiveCAP should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing FiveCAP's financial condition.

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. 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-05-09-00089 in all correspondence.

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

RESULTS OF LIMITED SCOPE REVIEW AT FIVECAP, INC., FOR THE PERIOD NOVEMBER 1, 2005, THROUGH JULY 31, 2009

Daniel R. Levinson
Inspector General

January 2010
A-05-09-00089

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 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 activities.

FiveCAP, Inc. (FiveCAP), a 501(c)(3), private, non-profit Michigan corporation, operates Head Start and Early Head Start programs that provide education, health, and social services to low-income pre-school children and their families in the Michigan counties of Manistee, Mason, Lake, and Newaygo.

FiveCAP is funded primarily through Federal and local government grants. During fiscal years (FY) 2006 through 2009, ACF provided grant funds of approximately $3 million annually to FiveCAP. FiveCAP received Recovery Act grant funding for a 15-month period ending September 30, 2010 totaling $221,261 for cost-of-living increases and quality improvement.

FiveCAP filed for Chapter 11 Bankruptcy on April 20, 2006 and was in bankruptcy status as of the end of our field work. The Notes to Financial Statements for FiveCAP's FY 2006 Office of Management and Budget Circular A-133 audit (Notes) state that FiveCAP filed Chapter 11 to obtain confirmation of a plan of reorganization to satisfy the claims of the National Labor Relations Board and others. The Notes also state that the Chapter 11 Plan is to be funded by corporate funds that are not held in trust or otherwise restricted by government rules and regulations.

OBJECTIVES

The objectives of our limited scope review were to determine whether FiveCAP addressed past deficiencies, resolved issues regarding financial viability and claims for vacation costs, and if it has the capacity to manage and account for Federal funds.

SUMMARY OF FINDINGS

FiveCAP's overall financial position remains an area of concern. Based on its current financial condition, FiveCAP can not ensure the continuing viability of the organization unless it restructures its debt or receives additional funding. In addition, FiveCAP may have claimed unreasonable compensation costs from the Head Start program for its Executive Director's vacation pay in lieu of time off.

RECOMMENDATION

In determining whether FiveCAP should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing FiveCAP's financial condition.

FIVECAP COMMENTS

In written comments on our draft report, FiveCAP stated that it disputes the finding that it is not financially viable and believes the finding should be removed from the final report. FiveCAP disagrees with the methods used to assess financial viability and OIG's reporting of the short term liquidity analysis.

FiveCAP disputed the finding that $32,765 for vacation compensation for the Executive Director from the period of November 1, 2005 through July 31, 2009 was unallowable. FiveCAP stated that the Board of Directors determined that the amounts of vacation days and pay were appropriate under the circumstances.

FiveCap's comments are included in their entirety as the Appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing FiveCAP's comments, we maintain that our findings regarding its financial viability remain valid.

We did amend our finding on vacation compensation to state that FiveCAP may have claimed unreasonable vacation compensation in lieu of vacation time for the Executive Director. We are concerned both with the amount of compensation paid in lieu of vacation time throughout our review period and in FY 2008 the amount of vacation time provided to the Executive Director.

TABLE OF CONTENTS

INTRODUCTION

BACKGROUND

Head Start Program

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. The Head Start Act (42 U.S.C. § 9831 et. seq.) was most recently amended and reauthorized by Public Law 110-134, Improving Head Start for School Readiness Act of 2007. 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, 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 improve staff compensation and training, upgrade Head Start centers and classrooms, increase hours of operation, and enhance transportation services. An additional $356 million of Recovery Act funds, along with fiscal year 2009 appropriation funds, were allocated to award all Head Start grantees a nearly five percent cost-of-living increase and bolster training and technical assistance activities.

FiveCAP, Inc.

FiveCAP, Inc. (FiveCAP), a 501(c)(3), private, non-profit Michigan corporation, operates Head Start and Early Head Start programs that provide education, health, and social services to low-income pre-school children and their families in the Michigan counties of Manistee, Mason, Lake, and Newaygo.

FiveCAP is funded primarily through Federal and local government grants. During fiscal years (FY) 2006 through 2009[1], ACF provided grant funds of approximately $3 million annually to FiveCAP. FiveCAP received Recovery Act grant funding for a 15-month period ending September 30, 2010 totaling $221,261 for cost-of-living increases and quality improvement.

---

[1]FiveCAP's fiscal year is November 1 to October 31.

FiveCAP filed for Chapter 11 Bankruptcy on April 20, 2006 and was in bankruptcy status as of the end of our field work. The Notes to Financial Statements for FiveCAP's FY 2006 Office of Management and Budget (OMB) Circular A-133 audit (Notes) state that FiveCAP filed Chapter 11 to obtain confirmation of a plan of reorganization to satisfy the claims of the National Labor Relations Board and others. The Notes also state that the Chapter 11 plan is to be funded by corporate funds that are not held in trust or otherwise restricted by government rules and regulations.

Requirements for Federal Grantees

Pursuant to 45 CFR § 74.21, grantees are required to maintain financial management systems that contain written procedures for determining the reasonableness, allocability, and allowability of costs. Grantees must maintain accounting records that are supported by source documentation and must maintain financial systems that provide for accurate and complete reporting of grant related financial data. Grantees are also required to compare outlays with budget amounts for each award and may use grant funds only for authorized purposes.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our limited scope review were to determine whether FiveCAP addressed past deficiencies, resolved issues regarding financial viability and claims for vacation costs, and if it has the capacity to manage and account for Federal funds.

Scope

This review was performed based upon a limited scope request from ACF, dated June 19, 2009, to determine whether FiveCAP should be awarded additional Head Start and Recovery Act grant funding. Therefore, we did not perform an overall assessment of FiveCAP's internal control structure. Rather, we reviewed only the internal controls that pertained directly to our objective. Our review period was November 1, 2005, through July 31, 2009.

We performed our fieldwork at FiveCAP's administrative office in Scottville, Michigan, during July and August 2009.

Methodology

To accomplish our objective, we;

- reviewed relevant Federal laws, regulations, and guidance;
- obtained Federal grant award documentation to determine FiveCAP Federal funding;
- reviewed FiveCAP's "Personnel Policies & Procedures Manual for

Administrative/Supervisory Employees;"

- reviewed FiveCAP's Executive Director employment contracts;
- reviewed FiveCAP's financial statements for FYs 2006 through 2008;
- reviewed FiveCAP's FYs 2006, 2007, and 2008 OMB Circular A-133 audit reports;
- reviewed FiveCAP's SF-269, Financial Status Reports, submitted to ACF; and
- performed liquidity and stability analyses of FiveCAP's finances.

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

FiveCAP's overall financial position remains an area of concern. Based on its current financial condition, FiveCAP can not ensure the continuing viability of the organization unless it restructures its debt or receives additional funding. In addition, FiveCAP may have claimed unreasonable compensation costs from the Head Start program for its Executive Director's vacation time and vacation pay in lieu of time off.

FIVECAP NOT FINANCIALLY VIABLE

To determine whether FiveCAP is financially viable, we performed liquidity and stability analyses of FiveCAP finances for FYs 2006 through 2008.

Short Term Liquidity Analysis

We performed a liquidity analysis, which measures the relationship of total revenues to total expenses, to determine FiveCAP's ability to pay its current obligations. Generally, for an organization to be considered fiscally sound, revenues should be greater than expenses. Our analysis indicated the following:

Fiscal Year	Reported Total Revenue	Reported Total Expenses	Net Revenue
2006	$5,595,552	$6,112,258	($516,706)
2007	4,794,775	4,562,144	232,631
2008	5,227,461	5,421,938	(194,477)
Total	$15,617,788	$16,096,340	($478,552)

During the three year period, FiveCAP reported total expenses that exceeded reported total revenues in two of the three years and had a three year net total revenue loss of $478,552.

This financial position is an area of concern.

Short Term Stability Analyses

We performed a temporarily restricted net asset ratio, which measures the relationship of temporary restricted net assets and deferred revenue to cash and cash equivalents, to determine a measurement of fiscal responsibility. Generally, for an organization to be considered fiscally sound, the ratio should be 1:1. Our analysis disclosed the following:

Fiscal Year	Temporary Restricted Net Asset Ratio
2006	2.05
2007	2.04
2008	1.92

The high ratios (each year's ratio is greater than 1:1) for temporarily restricted net assets indicate that FiveCAP may be borrowing from net assets intended to be used in future periods. This financial position is an area of concern.

We performed a quick ratio analysis, the relationship of current assets to current liabilities, to determine if FiveCAP had sufficient cash available to pay bills due over the next year. Generally, if an entity's ratio is below 1:1, the entity would be in danger of insufficient cash to pay current bills. Our analysis disclosed the following:

Fiscal Year	Current Assets to Current Liabilities Ratio
2006	0.48
2007	0.61
2008	0.57

The low ratios for current assets to current liabilities indicate that FiveCAP may be in danger of insufficient cash to pay current bills. This financial position is an area of concern.

POTENTIAL UNALLOWABLE COSTS - VACATION PAY

To determine whether the Executive Director's salary, including vacation time and vacation pay in lieu of time off, was reasonable and allowable we reviewed Federal regulations (45 CFR § 74.27 and the corresponding OMB Circular), FiveCAP's "Personnel Policies & Procedures Manual for Administrative/Supervisory Employees" and the employment contracts of the Executive Director during the period in question.

OMB Circular A-122, Att. B, § 8.b.(1) (2 CFR Part 230, App. B, § 8.b.(1)) states that compensation costs 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. Additionally, the Circular provides that when the organization is predominantly engaged in federally-sponsored activities and in cases where the kind of employees required for the Federal activities are not found in the organization's other activities, compensation for employees on federally sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved (2 CFR Part 230, App. B, § 8.c.(2)). The Circular further states that in determining the reasonableness of costs, significant deviations from the established practices of the organization that may unjustifiably increase the award costs should be considered (2 CFR Part 230, App. A, § A.3.d).

FiveCAP's "Personnel Policies & Procedures Manual for Administrative/Supervisory Employees" provides for a maximum of 15 vacation days per year for all FiveCAP employees. The manual prohibits vacation pay in lieu of actual vacation time without the approval of the Executive Director. The Executive Director's contract for this period provided 30 days paid vacation per year starting June 28, 2002, and 60 days paid vacation per year starting March 1, 2008. The Executive Director's vacation days were increased by the Board of Directors to make up for severance pay and other compensation not received by the Executive Director in prior years. The contract provided for pay in lieu of time off for the Executive Director and was authorized by the Board Chairperson.

Our analysis of FiveCAP's Executive Director's allotted vacation days and pay in lieu of time off disclosed the following:

Fiscal Year	Total Vacation Days Granted to Executive Director	Total Vacation Days Allowed By FiveCAP Policy	Total Vacation Days Paid In Lieu of Time Off	Claims For Vacation Days in Lieu of Time Off
2006	30	15	6	$3,003
2007	30	15	22	11,101
2008	60	15	36	18,661
Total	120	45	64	$32,765

We are concerned that FiveCAP may have provided the Executive Director an unreasonable amount of vacation time in fiscal year 2008 (12 weeks of paid time off) and may have claimed unreasonable vacation compensation in lieu of vacation time for the Executive Director for November 1, 2005, through July 31, 2009. Three months of paid vacation, more than half of which was provided in cash in addition to the Executive Director's regular pay, seems all the more unreasonable given the financial difficulties that FiveCAP was facing during this period.

CONCLUSION

FiveCAP's overall financial position remains an area of concern, and it may have claimed unreasonable costs related to vacation pay for the Head Start program.

RECOMMENDATION

In determining whether FiveCAP should be awarded additional Head Start and Recovery Act grant funding, we recommend that ACF consider the information presented in this report in assessing FiveCAP's financial condition.

FIVECAP COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, FiveCAP stated that it disputes the finding that it is not financially viable and believes the finding should be removed from the final report. FiveCAP's comments are included in their entirety as the Appendix.

Financial Viability

FiveCAP Comments

FiveCAP stated that it disagreed with the methods used to assess financial viability. FiveCAP stated that the method that the OIG used to calculate the temporarily restricted net asset ratio (temporary restricted net assets plus deferred revenue divided by cash and cash equivalents) was flawed because it did not include restricted cash as part of current assets. FiveCAP stated that restricted cash is related to deferred revenue and thus should be included in the calculation.

Further, FiveCAP stated that the quick ratio used by the OIG measured the relationship of current assets to current liabilities (cash plus accounts receivable divided by current liabilities). FiveCAP stated that if deferred revenue is to be included on the liability side of the equation, then restricted cash should be included in the asset side of the equation since, as noted above, restricted cash is related to deferred revenue. FiveCAP indicated that when the standard methods are applied, FiveCAP shows acceptable ratios in both tests described above.

FiveCAP stated that the OIG's short term liquidity analysis showed a revenue loss over the three-year period of FY 2006, 2007 and 2008, but did not explain the events leading to the numbers. FiveCAP stated that the outcome is incorrect because it recorded a liability of $584,775 in 2006, resulting from a determination made in an administrative proceeding which was lowered in 2007 by almost half ($300,000). FiveCAP indicated that the liability was adjusted down accordingly and that it continues to negotiate the amount of the liability and anticipates settling the claim in the near future with the use of available assets. FiveCAP stated that only corporate assets were ever at risk in this matter; at no time were Grant funds at risk.

Office of Inspector General Response

We maintain that our finding that FiveCAP's overall financial position and viability of the organization remain an area of concern. Restricted cash should be used in the denominator of the temporarily restricted net asset ratio and the numerator of the quick ratio. The Statement of Financial Accounting Standards No. 117, Financial Statements of Not-for-Profit Organizations, states that cash or other assets received with a donor-imposed restriction that limits their use to long-term purposes should not be classified with cash or other assets that are unrestricted and available for current use. The restricted cash balances in place at FiveCAP are for the purposes of loans to individuals for the purchase of personal vehicles and matches for savings accounts of qualified individuals. The classification of the balances alone indicates a long-term nature, e.g., vehicle loans and savings accounts, and the fact that the vehicle loan and savings account balances did not materially change over the period of September 30, 2005 though September 30, 2008 supports our classification of these balances as non-current assets.

With regards to our short term liquidity analysis, the variables included in our analysis were revenues and expenditures, not assets and liabilities. FiveCAP's statement that our report infers that revenue loss exceeds available assets is not directly related to our analysis of liquidity as reported.

Vacation Pay

FiveCAP Comments

FiveCAP stated that it disputed the finding that $32,765 for vacation compensation for the Executive Director from the period of November 1, 2005 through July 31, 2009 was unallowable. FiveCAP states that OMB Circular A-122 does not define what form the established policies of the organization take, nor does it require all policies to be in one personnel manual. FiveCAP indicated that the Executive Director employment contract, signed by the Board of Directors, contains policy provisions allowing the Executive Director certain vacation days and that the Personnel Policies and Procedures Manual expressly includes provisions that allow the Board of Directors to modify benefits as they see fit. FiveCAP stated that the Board of Directors determined that the amounts of vacation days and pay were appropriate under the circumstances.

Office of Inspector General Response

We amended our finding to state that FiveCAP may have claimed unreasonable vacation time and vacation compensation in lieu of vacation time for the Executive Director. For the reasons stated in our findings we are concerned both with the amount of compensation paid in lieu of vacation time throughout our review period and in FY 2008 the amount of vacation time provided to the Executive Director. We leave the determination to ACF of whether this amount of vacation time and amount of days granted of vacation pay in addition to regular pay was reasonable, both in comparison to prior practices of this organization, in comparison with other organizations in similar situations and given the financial turmoil that this particular grantee was facing.

APPENDIX

APPENDIX: AUDITEE COMMENTS

October 6, 2009

Marc Gustafson
Regional Inspector General for Audit Services
Department of Health and Human Services
Office of Audit Services
233 North Michigan Avenue
Chicago, IL 60601

Report Number: A-05-09-00089

Dear Mr. Gustafson:

FiveCAP, Inc. ("FiveCAP") appreciates the opportunity to comment on the draft audit report, A-05-09-00089, dated September 2009 (the "report") from the Department of Health and Human Services' Office of Inspector General ("OIG") covering November 1, 2005 through July 31, 2009 as well as the extension given by the OIG on our response. We respectfully disagree with all three draft findings found in the draft report. Below we provide the rationale for why these draft findings are incorrect and should be removed prior to the OIG's issuance of the final audit report. We take each finding in turn:

<u>FiveCAP's Financial Viability</u>

FiveCAP disputes the finding that it is not financially viable because we disagree with the methods used to assess viability. The OIG's Short Term Stability Analysis and Quick Ratio methods do not comport with Standard Methods. Further, the Liquidity Analysis does not take into account a settlement in progress. Accordingly, the finding of lack of financial viability should be removed from the final report.

In terms of the Short Term Stability Analyses, which included calculation of the Temporarily Restricted Net Asset Ratio and a Quick Ratio, FiveCAP disagrees with the method used. The OIG's draft of the Temporarily Restricted Net Asset Ratio measured the relationship of temporary restricted net assets and deferred revenue to cash and cash equivalents. It used a formula of Temporarily Restricted Net Assets plus Deferred Revenue divided by Cash and Cash Equivalents. This method is flawed because it did not include Restricted Cash as part of current assets. Restricted Cash is related to Deferred Revenue and thus should be included in the calculation. The calculation should be Temporarily Restricted Net Assets plus Deferred Revenue divided by Cash plus Cash Equivalents plus Restricted Cash. The attached report compares the OIG/OAS calculation to the Standard Method of Calculation.

Further, the Quick Ratio measured the relationship of current assets to current liabilities. The formula used by the OIG was Cash plus Accounts Receivable divided by Current Liabilities. If Deferred Revenue is to be included on the liability side of the equation, then Restricted Cash should be included in the asset side of the equation since, as noted above, Restricted Cash is related to Deferred Revenue. The attached report compares the OIG/OAS calculation to the Standard Method of Calculation.

When the Standard Methods are applied, FiveCAP shows acceptable ratios in both tests described above. Accordingly, the OIG should remove this finding from the report.

In addition, the OIG's Short Term Liquidity Analysis showed a revenue loss over the three-year period of FY 2006, 2007 and 2008. The draft report ends there, however, without explaining the events leading to those numbers and infers that revenue loss exceeds available assets. This outcome is incorrect because that is not FiveCAP's situation. In 2006, FiveCAP recorded a liability of $584,775 as the result of a determination made in an administrative proceeding. In 2007, however, the settlement amount in the case was determined to be lower by almost half ($300,000). As such, the liability on FiveCAP's books was adjusted down accordingly. Currently, FiveCAP continues to negotiate the amount of the liability and anticipates settling the claim in the near future with the use of available assets. In addition, only corporate assets were ever at risk in this matter; at no time were Grant funds at risk. FiveCAP has successfully met and exceeded all of its obligations to its funders during the periods examined, and continues to do so.

In sum, because of the methodological flaws and incorrect outcomes listed in this finding, it should be removed.

<u>Vacation Pay</u>

FiveCAP disputes the finding that $32,765 for vacation compensation for the Executive Director from the period of November 1, 2005 through July 31, 2009 is unallowable under Office of Management and Budget Circular A-122 (codified at 2 C.F.R. Part 230). The draft report cites A-122, Att. B, §8.b.(1) which states that

> Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that: (1) 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;…

Importantly, this section of A-122 requires that compensation "conforms to the established policy of the organization." (*Id.*) A-122 does not define what form the established policies of the organization must take, nor does it require all policies to be in one personnel manual. Contracts that a grantee signs are part of the employment policies of the organization. Yet the draft report focuses solely on one section of the "Personnel Policies and Procedures Manual" that contains a vacation day limitation and disregards the vacation provisions contained in the two Executive Director employment contracts that were agreed to by the Board of Directors (dated June 28, 2002 and March 1, 2008; shared with the OIG). Those two employment agreements contain policy provisions allowing the Executive Director certain vacation days, which is the longstanding practice of the organization.

Moreover, it should be noted that the same Employment Manual that the OIG relies upon states that "[t]he Board of Directors is responsible for establishing basic policy within which the agency operates" (at 1); "Benefits outlined in this document may be added to, expanded, reduced, deleted or otherwise modified by FiveCAP" and any such modifications "shall be solely within the discretion of FiveCAP" (at 1); and "FiveCAP reserved and retains, solely and exclusively, all rights to manage and operate its affairs and such rights of FiveCAP shall not in any way be abridged by the terms of this manual" (at 2). Thus, the Employment Manual expressly includes provisions that allow the Board of Directors to modify benefits as they see fit.

The Board did just that in the case of the Executive Director. The Executive Director's agreement covering 2002-2008 contains a policy provision that allows for "30 days paid vacation each year" and "[p]ay in lieu will be authorized by the Board Chairperson." The agreement covering 2008-2013 allows for "60 days paid vacation each year" and [p]ay in lieu will be authorized by the Board Chairperson." Accordingly, the draft report's finding that $3,003 for 2006, $11,101 for 2007, and $18,661 for 2008 were unallowable costs is simply incorrect.

Further, in its reviews of the Executive Director, the Board determined that these amounts of vacation days and pay were appropriate under the circumstances. When it determined the amounts of vacation time in the policies for the Executive Director, the Board acted prudently in determining that these amounts of vacation days were necessary, due to additional work load and lack of vacation days previously taken.

In sum, the OIG should remove this finding from the draft report because the Executive Director's vacation days are allowable costs under the policies of the organization[1]

<u>Legal Fees</u>[2]

FiveCAP disputes the finding that $1,638 of legal fees are unallowable costs under Office of Management and Budget Circular A-122 (codified at 2 C.F.R. Part 230). The draft report cites A-122, Att. B §10.b.(1)(c) which states that

---

[1] If, after reviewing the evidence, the OIG still fails to agree with FiveCAP on this matter, we urge it to at least review and recalculate the amounts of "unallowable vacation pay costs claimed" it lists in the draft report. It appears from the report that the OIG has tried to disallow the entire amount of vacation pay to the Executive Director, not just any amounts over the 15 day policy that, as explained above, do not apply. Thus, the OIG's calculation and approach is inaccurate.

[2] Office of Inspector General Note – This paragraph is not applicable because the finding referred to by the auditee is not included in the report.

> Except as otherwise described herein, costs incurred in connection with any criminal, civil or administrative proceeding. . . commenced by the Federal Government, or a State, local or foreign government, are not allowable if the proceeding: (1) relates to a violation of, or failure to comply with, a Federal, State, local or foreign statute or regulation by the organization (including its agents and employees), and (2) results in. . .: (c) In the case of any civil or administrative proceeding, the imposition of a monetary penalty.

While A-122, Att. B, §10.a.(5) does include “an investigation” in the definition of a “proceeding,” in the EEOC investigation that resulted from the one complaint in question, there was no “imposition of a monetary penalty.” In fact, quite the opposite is true. The EEOC closed its case and the complaint was dismissed (*see* Notice of Disposition and Order of Dismissal EEOC #210A402670 received by FiveCAP on 2/3/05, shared with the OIG). Further, both parties entered into a final and binding consent decree in a settlement process urged by the mediator appointed by the court that states that “[t]his agreement. . . shall not constitute an adjudication or finding on the merits of this case and shall not be construed as an admission by Defendant of any violation. . .” (*see* Consent Decree for case number 1:05-CV-0153, at 3, dated 11/13/2006, shared with the OIG’s team). Thus, with no final adjudication or finding, no monetary penalty was imposed.

The OIG misconstrued the “compensation” provided for in the consent decree as a “monetary penalty.” (*See id*., page 3.) A-122, Att. B, §10.a.(4), however, states that a “[p]enalty does not include restitution, reimbursement, or compensatory damages.” The amount provided to the ex-employee through the consent decree was “compensation,” *i.e*., reimbursement (Consent decree, at 3.) and was intended to end the investigation and cover some of the cost of back pay to the complainant. As such, no “monetary penalty” was imposed in the settlement.

In addition, this case’s details and settlement were vetted with HHS attorneys in June of 2006. Accordingly, the OIG should remove this finding and allow the full amount of reasonable and allocable legal fees ($1,638) which are allowable costs. (*See* Community Action Commission of the Cincinnati Area, DAB No. 380 (1983)(noting that legal fees are generally allowable).

Sincerely,

Mary L. Trucks
Mary L. Trucks
Executive Director

Attachment

c: Clarence Hightower Jr., Senior Auditor
Mike Barton, Audit Manager
Bernice Culpepper, FiveCAP Board Chairperson