



# Document, Review, Follow & Plan: Lessons Learned from Recent Head Start Disallowances

By Michael Shepsis, Esq., CAPLAW

In four Department of Health and Human Services (HHS) Departmental Appeals Board (DAB) decisions, the Administration for Children and Families (ACF) disallowed Head Start program costs ranging from tens of thousands of dollars to upwards of a million. The DAB decisions addressed issues relating to: the non-federal share requirement; the drawing down of federal funds to pay costs; consulting and professional service contracts; and incentive compensation. Action steps discussed in this article concerning effective documentation and good practices, if followed, may help grantees avoid future, costly disallowances similar to the issues addressed in these DAB decisions.

## Insufficient Non-Federal Share Documentation

A California Community Action Agency's (CAA's) failure to either raise the necessary non-federal share amount or obtain a waiver resulted in the DAB upholding ACF's disallowance of \$79,286.52 in Head Start costs. The CAA which operated Head Start, Early Head Start, and Migrant and Seasonal Head Start programs failed to provide adequate documentation showing that it made a reasonable effort to meet the requirement for its 2008-2009 program year.<sup>1</sup>

Because the Head Start Act generally caps the permissible federal share of the total costs of a Head Start program at 80%,<sup>2</sup> a Head Start grantee must obtain 20% of its Head Start budget through non-federal sources. When doing so, the grantee must ensure that funding from state sources does not include federal source funds.<sup>3</sup> HHS' uniform administrative grant requirements also allow any portion of the non-federal share requirement to consist of an "in-kind" donation of goods or services.<sup>4</sup>

The Head Start Act also specifies that HHS may approve a higher percentage of federal participation in the award if it determines that doing so is required to further the purposes of the Head Start Act. In making that determination, HHS will consider the following factors:

"HHS may approve a higher percentage of federal participation in the award if..."

- The lack of resources available in the community that may prevent the Head Start grantee from providing all or a portion of the required non-Federal share
- The impact of the cost the Head Start grantee may incur in initial years it runs the Head Start program
- The impact of unanticipated increase in costs the grantee may incur to carry out the program
- The impact of a major disaster on the grantee's community
- The impact on the community if the grantee were to cease operating the Head Start program<sup>5</sup>

The Head Start Program Performance Standards provide that a grantee may seek a waiver to the non-federal share requirement if (a) it has made a "reasonable effort" to meet the requirement, and (b) the grantee is located in either (i) a county that has a personal per capita income of less than \$3,000 per year, or (ii) a county that has been involved in a major disaster.<sup>6</sup> (This provision was adopted before passage of the current non-federal share language in the Head Start Act, which expanded HHS's authority to issue waivers.)

The CAA contended that it should have been granted a retroactive waiver of the non-federal share requirement because it is located in a county that experienced a major drought adversely affecting its ability to maintain enrollment in its Migrant Head Start program and to obtain in-kind contributions in the form of parental volunteering and business service donations. The CAA requested the waiver

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## SIDEBAR

In 2012, ACF issued further guidance on the non-federal share requirement in the form of Program Instruction 12-02 which states that: "Grantees actively seeking non-Federal share but facing community circumstances that create a concern that the 20 percent match requirement cannot be met should consider submitting a written request for waiver with their annual refunding application. If match requirements cannot be met due to circumstances arising during the budget period, grantees are encouraged to immediately submit a request for waiver to their Regional Office."<sup>7</sup> However, this guidance was not mentioned in the DAB decision, which related to the use of funds from the 2008-2009 program year.

and property damage resulting from weatherization projects is an allowable expense.<sup>6</sup> However, this type of insurance may not cover all of the scenarios leading to additional work that may need to be done on a completed unit. Ultimately, a CAA should work with an insurance specialist as well as an attorney in its state that specializes in construction matters to determine what, if any, insurance may be available.

**What should a CAA do if it is currently facing the scenario?** A CAA should initially determine if it is liable for the repair. If the CAA used in-house crews and determines that it is wholly or partially liable, its insurance may cover the cost of repairs on a completed unit and/or the CAA may use unrestricted funds to pay for such repairs. If the CAA used a contractor, the agreement it entered into with the contractor may require the contractor to take responsibility for the repair and, if not, the CAA should consider working with an attorney in its state that specializes in construction matters to determine what, if any, implied warranties may apply. Additionally, the contractor's insurance may cover the cost of such repairs.

*(See endnotes on pages 20-21)*



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eight months after the budget period had ended. In support of its request, it provided statements by its former chief financial officer (CFO) and its current executive director that it had made its “best efforts” to meet the non-federal share requirement. The CAA explained that in addition to the drought, there was a shortage of community resources because of the location and demographics of the community.

ACF rejected the CAA's waiver request, and the DAB agreed. Without deciding if an untimely request could be approved retroactively, the DAB found that the CAA failed to provide sufficient evidence showing it had made the reasonable effort required by the Performance Standards to meet the non-federal share requirement. The DAB explained that

declarations by the CAA's management that “best efforts” had been made did not shed light on what the efforts had actually been, and, as a result, the DAB could not assess the reasonableness of the CAA's attempts to find sources of non-federal funds. The DAB explained that sufficient documentation would describe the steps that the CAA had taken to generate non-federal share donations despite the challenges that it faced.

The CAA also argued that it had not received enough guidance from ACF on the procedure for requesting a waiver, and that it was unclear who had the burden of initiating the application and providing supporting evidence. The DAB rejected this argument by pointing out that the CAA's notice of award indicated that the award was subject to various regulations, including Performance Standards at 45 C.F.R. Part 1301. Among other things, these regulations outline the non-federal share requirement and that additional federal financial assistance may be approved by an HHS official “on the basis of a written application and any supporting evidence he or she may require.”<sup>8</sup> These regulations, therefore, put the CAA on notice that it needed to provide 20% of the program costs and obtain approval from ACF to contribute a lesser amount. The regulations also make clear that the CAA initiates the waiver request, since it is in a position to know if such a request is necessary and would possess evidence supporting the request.

### **Lessons Learned:**

- If your organization anticipates difficulty in meeting the non-federal share requirement, apply for a waiver with your annual refunding application or submit a waiver request to the ACF Regional Office as early as possible in the program year.
- Document all steps taken to obtain non-federal share funds and in-kind donations. The documentation should evidence the reasonable efforts made to obtain funding and donations and can later be used to support a waiver request.

## Improper Draw Downs and Lack of Records

A Nebraska CAA incurred a disallowance totaling \$172,399.52 resulting from: (1) drawing down its remaining program funds, \$80,917.32, for program year (PY) 2010 nearly two weeks prior to using the funds and failing to produce records showing how the funds were spent and (2) using \$91,482.20 of PY 2011 funds for payroll expenses incurred in PY 2010.<sup>9</sup> The HHS uniform administrative grant requirements specify that cash advances to a federal grant recipient must be limited to the minimum amount needed and timed to be in accordance with an organization's actual, immediate cash requirements. The timing and amount of cash advances must be as close as administratively feasible to the actual

“The timing and amount of cash advances must be as close as administratively feasible to the actual disbursements for program costs.”

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disbursements for program costs.<sup>10</sup> A grantee may only charge to an award the allowable costs that result from obligations incurred during the funding period.<sup>11</sup> Grant expenditures incurred before or after a budget period are not allocable to that budget period.<sup>12</sup> Furthermore, for costs to be allowable, the federal cost principles require, among other conditions, that the costs be adequately documented and allocable to the award.<sup>13</sup> The grant recipient bears the burden of documenting the existence and allowability of costs.<sup>14</sup>

## Disallowance of \$80,917.32

Several days prior to October 31, 2010, the end of the CAA's PY 2010, it drew down the remainder of its Head Start funds in the amount of \$80,917.32. The CAA asserted that at the time of the drawdown it had obligated \$82,333.98 of its \$91,482.20 bi-monthly payroll expense for the two-week period between October 16, 2010 and October 31, 2010. The CAA also asserted that pursuant to its policy of paying payroll on the 10<sup>th</sup> and the 25<sup>th</sup> of every month, on November 10, 2010 it used the drawn down to pay most of the \$91,482.20 payroll. When ACF questioned the drawdown during its on-site review, the CAA's fiscal officer "stated simply that he had drawn the Head Start balance of [the program year] available funds". The CAA later noted that even though the funds were not needed until November 10, they were obligated and connected to an expense that had accrued by the date of the draw down.

The DAB found that the CAA failed to comply with its obligation to draw down the minimum amount of funds required to meet its immediate cash requirements. The DAB explained that the obligation of a cost does not demonstrate

the existence of an "immediate cash requirement." Even if the funds had been obligated by October 28, they were not needed until November 10. According to the DAB, the CAA provided no evidence that it actually spent the \$80,917.36 to make the November 10 payroll payment. In fact, the CAA admitted

"...the obligation of a cost does not demonstrate the existence of an 'immediate cash requirement.'"

to having used the other disallowed amount, \$91,482.20 from PY 2011, to pay for the PY 2010 payroll expenses that it initially claimed to have paid in part with the \$80,917.32 amount. The DAB found further that the fiscal officer's comment during the on-site review and the complete drawdown of the remaining PY 2010 funds created the appearance that the funds were drawn down simply because the PY was ending and not to meet an immediate and permissible cash need.

The DAB also found that the CAA failed to meet its burden of documenting that the funds were spent on allowable and allocable charges to its Head Start grant for PY 2010. The records the CAA produced reflected payments for payroll expenses accrued in PY 2009 rather than PY 2010 and listed all expenditures for its Head Start and Early Head

Start programs rather than showing a breakdown of costs allocated to the appropriate program.

## Disallowance of \$91,582.20

The CAA did not contest the DAB's decision to sustain ACF's disallowance of \$91,482.20 from PY 2011 based on the CAA having used those funds to pay for payroll expenses incurred during PY 2010. Rather, the CAA argued that it had offset the improper use of the funds because it "used corporate money acquired by cashing out certain certificates of deposit owned by the program to pay the final payroll of grant year 2011" which equaled \$91,482.20. In support of its argument, the CAA relied on a prior DAB decision recognizing that a grantee may reduce or offset a disallowance by documenting that it incurred previously unclaimed allowable and allocable costs that it paid for with its own funds.<sup>15</sup> The CAA also produced general ledger transactions and "payroll expense allocations" that showed payment of \$91,482.20 in payroll expenses on November 10, 2010, and that as of March 12, 2013, it had reversed the journal entries charging those costs to PY 2011.

The DAB rejected the CAA's offset argument and distinguished the facts surrounding its prior decision with the ones here. Unlike the grant recipient in the prior decision, the CAA in this case failed to show that it had spent \$91,482.20 of its own non-federal funds on allowable Head Start program costs that it had not previously charged to Head Start funds. The grant recipient in the prior case had submitted a 66-page spreadsheet that detailed previously unclaimed Head Start expenditures, including the date, the payee, the purpose, a check number where applicable, and an account classification number.<sup>16</sup> These records sufficiently evidenced that the grant recipient had paid allowable costs that it had not previously charged to federal funds with non-federal funds. The records also sufficiently showed that the non-federal funds used by the grantee in the prior decision to offset the improper charge had not also been used to meet its required non-federal share. In the case here, however, the DAB concluded that the CAA failed to provide documentation sufficient to establish that the CAA used non-federal funds to pay for \$91,482.20 in previously unclaimed Head Start program expenses for PY 2011 and that any non-federal funds used as an offset were not also part of the CAA's required non-federal share. Subsequently, the CAA failed to meet its burden of documenting the existence and allowability of its expenditures of federal funds.

### Lessons Learned:

- Do not draw down on federal funds simply because the money is available. Draw downs must be supported by documentation evidencing what the funds will be used for and that the use is both allowable and allocable to the budget period to which they are being charged.
- Avoid using Head Start funds or any other federal funds available on an advance basis to cover costs of other programs or activities of the organization, even for a short period. "Loans" of this sort are strictly prohibited.

- Limit draw downs of cash advances to the minimum amount needed and time those draw downs as close as administratively feasible to actual disbursements for program costs.
- Monitor carefully your organization's cash flow and have procedures in place to minimize the time that federal funds sit in your organization's bank account (and keep in mind that interest on those funds must generally be remitted to the federal government).
- Maintain detailed records of all program expenditures, including, for example: information on the date of payment, payee, purpose, check number where applicable, account classification number, and the source of funds used to pay each expenditure. If a federal funding source disallows costs, an organization may be able to reduce the amount of the disallowance by showing that it spent non-federal funds on allowable costs that it had not previously charged to the federal grant at issue. However, your organization must be able to produce adequate documentation to show that no federal money was used for the offset and that amounts used to offset the disallowance were not also used to support the non federal share requirement.

## Insufficient Consulting and Professional Services Documentation

“Under the federal cost principles, a cost may be charged to a federal award if... it is reasonable and allocable, and adequately documented.”

Inadequate documentation led to a \$34,700 disallowance for consulting and IT professional services incurred by a Texas CAA's Head Start program.<sup>17</sup> Under the federal cost principles, a cost may be charged to a federal award if, among other requirements, it is reasonable and allocable, and adequately documented.<sup>18</sup> When determining if a cost related

to consulting or professional services is reasonable and allowable, the following factors should be considered and supported with evidence:

- The nature and scope of the service rendered in relation to the service required;
- The necessity of contracting for the service, considering the organization's capability in the particular area;
- The qualifications of the individual rendering the service and the customary fee charged; and
- The adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).<sup>19</sup>

Furthermore, the HHS uniform administrative grant requirements require a Head Start grantee to have in place a financial management system that provides effective

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control over money and property, maintains records that identify the source and application of federal funds, and consists of accounting records that are supported by source documentation.<sup>20</sup>

The Texas CAA entered into two consulting contracts and one contract for professional IT services. Upon the request of ACF, the federal Office of Inspector General (OIG) conducted an audit of the CAA's Head Start program which questioned costs associated with these contracts.<sup>21</sup>

In the first consulting contract, the CAA paid another organization a nonrefundable fixed fee of \$20,000 for technical training and assistance (T&TA) on an "ongoing, as needed basis." In support of this cost, the CAA provided the contract, a general ledger entry, and sign-in sheets indicating that some training had occurred. OIG found, and the DAB agreed, that the documentation was inadequate because it did not sufficiently support the reasonableness of the payment for the services provided. According to the DAB, the CAA should have produced detailed descriptions of services and time spent such as an invoice that could have been used to compare the services provided with the amount paid. Both OIG and the DAB found the sign-in sheets to be inadequate because they did not contain sufficient detail on the amount or type of training provided. The CAA failed to provide adequate documentation detailing the specific trainings that had been conducted or technical assistance received, an explanation as to why it was necessary to contract for such services, and the customary fees charged for such services.

In the second consulting contract, the CAA paid the executive director of another organization \$7,500 to assist with preparing a facilities acquisition application "on an as needed basis." To support this cost the CAA provided OIG with the completed facilities application, the consulting contract and a general ledger excerpt recording this cost. OIG found this support to be insufficient, and the DAB agreed, as the documentation failed to show that the \$7,500 payment was a reasonable fee for the contracted services. The facilities application did not show the "type or amount of work" the consultant provided and neither the consulting contract nor the ledger contained information about the specific assistance the consultant provided or the number of hours she worked.

In the third contract for maintenance and support of the CAA's information technology (IT) system, the estimated total cost for the services provided was \$4,519 per month, with the IT vendor donating \$2,334 per month and the CAA paying the remaining \$2,185 per month. The CAA allocated \$600 per month of this cost to its Head Start program for a total program year cost of \$7,200. The CAA provided OIG with the IT contract, which based the vendor's monthly rate on projections about the CAA's IT needs, monthly invoices, and excerpts from the CAA's general ledger. The DAB found this documentation insufficient to determine whether the costs were reasonable, and consequently, allowable. The DAB explained that costs are not allowable simply because they were incurred pursuant to a written contract and invoices. The CAA's invoices failed to provide a detailed monthly listing of the services provided and the ledger only showed that the CAA's Head Start program had paid \$600 per month for IT support services. Even though the contract detailed the office locations and IT-related systems the vendor agreed to support along with the vendor's projected average number of support hours and monthly costs, it was not clear which of the listed office locations were used for Head Start-related activities and how the \$600 allocation to the Head Start grant was determined. Also, the CAA failed to provide information about the vendor's qualifications or customary fees charged for IT services. The DAB found that it was impossible to know whether the projected monthly rate was reasonable in relation to the services provided because the CAA failed to submit documentation showing either the services actually provided or the hours actually worked.

## Lessons Learned:

Consulting and professional service costs should be supported by documentation that shows that the costs are reasonable in relation to the services provided. Supporting documentation should address the:

- Purpose of the services,
- Need for the services,
- Qualifications of the service provider,
- Services actually provided and the realized benefit to the organization,
- Time spent providing the services and
- Customary fees for similar services from a similar provider.

## Failure to Follow Incentive Compensation Policy and Properly Obligate Repair Costs

Another Texas CAA's failure to follow its own compensation policies and maintain adequate documentation to support the reasonableness of payments made pursuant to those policies resulted in a disallowance of incentive compensation in the amount of \$1,332,608 charged by the CAA for 2010, 2011, and 2012 program years. The DAB also affirmed a disallowance of repair costs in the amount of \$59,653 for the CAA's charging of costs to the incorrect program year.<sup>22</sup>

The federal cost principles allow the charging of incentive compensation that is tied to cost reduction, or other efficient performance, such as improving productivity or safety, to the extent that the overall compensation is reasonable and pursuant to an agreement entered into in good faith before services are rendered, or pursuant to an established plan that is so consistently followed by the organization as to imply, in effect, an agreement to make such payment.<sup>23</sup> The Head Start performance standards require written personnel policies including a description of procedures for conducting staff performance appraisals that are approved by the Policy Council or Policy Committee.<sup>24</sup>

Additionally, the Head Start uniform administrative requirements and the federal cost principles require that for costs to be allowable they must be supported by evidence that they are allocable to the program year in which they are being charged.<sup>25</sup>

“...the federal cost principles require that for costs to be allowable they must be supported by evidence that they are allocable to the program year in which they are charged.”

### ***Disallowance of \$1,332,608***

The CAA maintained an incentive compensation policy (Policy) that paid staff additional amounts for consistent or exemplary job performance pursuant to an incentive plan approved by its executive director. The Policy contained the following guidelines:

- To be eligible for incentive compensation awards, managerial staff must present to the executive director a plan of performance that contains specific measures that must be met prior to payment of any incentive award. Performance measures may include cost reduction, efficient performance, safety awards, or other measurable performance indicators.
- Incentive compensation payments must be budgeted for, available, and allowable within contractual and grant award requirements.
- Incentive compensation cannot be awarded to an employee who had received a verbal or written performance warning within 90 days of the payment.
- For employees who have been with the CAA for more than one year, a current employee evaluation with a satisfactory evaluation on file.
- The Policy meets the criteria for the establishment of a consistent plan of incentive awards.

The CAA also adopted a compensation plan (Plan) that allowed for all staff to receive incentive compensation if management was successful in operating programs efficiently. The Plan provided higher pay for superior work performance than for average or below average performance and contained a matrix for “determining employee worth to the organization.” The matrix listed criteria on which different types of employees were to be rated and assigned points and specific letter grades. Also, pursuant to the Plan, manager ratings had to be composed of evaluations of

personnel performance appraisals, disciplinary history, and “discretionary input.”

### *2010 Program Year*

During its 2010 program year, the CAA awarded the same rate of incentive compensation to most of its non-management employees irrespective of their individual performance. The CAA evaluated the employees in groups based on their work locations and the organizational savings achieved by each group. In support of its actions, the CAA relied on two prior DAB decisions, one that allowed for an organization-wide one-time supplemental salary payment<sup>26</sup> and another that allowed for organization-wide bonus payments without evaluating individual employee performance.<sup>27</sup> The CAA also awarded incentive compensation to its management staff but, unlike the non-management employees, management was evaluated on individual performance pursuant to the Plan and the criteria outlined in the matrix. In support of those payments, the CAA initially provided payroll records that documented the ratings earned from individual performance evaluations. The CAA later provided the performance appraisal of a single non-management employee and stated that “appraisal documentation” could be provided for an additional unidentified 20 employees.

The DAB disallowed all of these incentive payments. As to the non-management employee payments, the DAB found that the CAA failed to follow its established policies by not evaluating each employee’s performance. The DAB differentiated the CAA’s situation from the prior DAB decisions by explaining that the supplemental salary and bonus payments that were allowed in the prior decisions were awarded in compliance with the grant recipients’ incentive compensation and personnel policies. As to the management payments, the DAB also found that the CAA failed to follow its established policy. Although managers were evaluated pursuant to the CAA’s Policy and Plan, the pay awarded was not linked to these evaluations. The documentation showed that some higher-rated managers received less compensation than lower-rated managers, and in other instances, managers that received equivalent ratings received different compensation awards. The CAA only provided records containing the tallied ratings, scores, and grades for each manager, and failed to provide the performance appraisals, disciplinary records, or documentation on “discretionary input” to support how these

“...the CAA... failed to provide the performance appraisals, disciplinary records, or documentation... to support how these ratings, scores, and grades were determined.”

ratings, scores, and grades were determined. The DAB noted that it was unclear if the CAA could provide appraisal documentation for all employees who were managers and, even with the appraisal documentation, it would be not be possible to determine if the Plan was followed without also reviewing disciplinary records and documentation on discretionary input. In addition, the DAB noted that, although

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the Plan stated that memoranda would be placed in employees' files to document that payment of incentive compensation was pursuant to factors in the Plan, the CAA did not produce any examples of these memoranda.

## *2011 and 2012 Program Years*

During its 2011 budget year the CAA again awarded incentive compensation pay to all of its employees. Unlike the prior year, the CAA conducted individual performance evaluations and determined ratings and grades for both non-management and management staff. In support of these payments, the CAA submitted payroll records containing all of the grades that employees received, and documentation for management employees containing the ratings that those employees received from the criteria in the Plan.

"...the documentation submitted revealed that the CAA had once again failed to follow its established policy."

The DAB found, however, that the documentation submitted revealed that the CAA had once again failed to follow its established policy. The DAB noted that several employees received less generous incentive compensation than did employees that received lower or equivalent grades. Additionally, the CAA again did not provide records to document the disciplinary actions and discretionary

input on evaluations of management. Thus, the DAB could not determine how the management employee ratings were determined, and whether compensation awards were in compliance with its Plan.

As in the prior two years, during its 2012 program year the CAA awarded incentive compensation to its employees. The DAB found again that the CAA failed to follow its policies. The CAA did not provide documentation substantiating that certain non-management employees met the qualifications to receive payments or to justify the varying amounts received. Additionally, like in prior years, the compensation awarded to some highly rated and graded management employees fell below, or was equivalent to less rated and graded employees.

### ***Incentive Compensation Not Reasonable***

Not only did the CAA fail to follow its Policy and Plan, it also was unable to show that the incentive compensation awards were reasonable. The federal cost principles require for costs to be allowable they must be reasonable.<sup>28</sup> For a cost to be reasonable it cannot exceed what a reasonable person under the circumstances would be willing to pay.<sup>29</sup> The cost should also be one that is ordinary and necessary for the operation of the organization or the performance of the grant award.<sup>30</sup> Prior DAB decisions have established the following factors should be considered to determine if incentive compensation is reasonable:

- The organization's compensation levels

- The compensation levels of comparable workers in the same geographic area
- Bonuses of similarly situated organizations
- Other bonuses paid to employees<sup>31</sup>

ACF asserted that the CAA failed to provide documentation showing that incentive compensation payments amounting to 9.35% of its total salary costs for fiscal year (FY) 2010, 12.19% of its total salary costs for FY 2011 and 6.99% of its total salary costs for FY 2012 were reasonable. One management employee received a payment that was 47.66% of her salary and, in FY 2011, 10 out of 12 management employees received incentive payments in excess of 10% of their salaries. The executive director received payments ranging from 8.10% to 29.49% of his salary.

The CAA argued that the awards were reasonable because employees' total compensation never exceeded the compensation set for Level II Executives by the federal government and was generally in line with the CAA's 2009 wage comparability study. The study showed compensation levels of comparable workers in the same geographic area; established salary ranges with minimum, midpoint, and maximum rates; and anticipated that the CAA would hire employees at the minimum rate unless a higher salary could be justified.

The DAB found the CAA's documentation insufficient to establish the reasonableness of the payments. The DAB explained that the CAA did not provide documentation to show that Level II Executives were comparable to the management positions at the CAA in terms of duties, responsibilities, and geography. The DAB acknowledged that wage comparability studies represent one factor to consider in the reasonableness analysis but noted that it is not a determinative factor. Moreover, the study provided by the CAA was from 2009 and only addressed base salaries, not bonuses or other incentive awards. The DAB explained that an employee's total compensation falling below the maximum range in the wage comparability study did not establish the reasonableness of pay for any particular employee. The DAB also noted that the total compensation paid to three employees exceeded the maximum amount established by the wage comparability study and that the CAA's Plan specifically limited an employee's total compensation to the maximum compensation in the study. The DAB found the incentive compensation payments to be arbitrary and not in conformity with what a reasonable person in similar circumstances would award. The DAB noted that incentive compensation to individuals with similar ratings was often inconsistent, and pay to employees with lower ratings was sometimes greater than the pay awarded to better rated employees.

"...wage comparability studies represent one factor to consider in the reasonableness analysis but noted that it is not a determinative factor."

## Disallowance of \$59,653

ACF disallowed floor repair costs of \$59,653 that the CAA charged to its Head Start program for fiscal year 2012 with a year end of April 30 because all of the quotes, invoices, purchase orders, check requests, and issued checks for these costs were dated July 2012. The CAA countered by providing a memorandum dated March 1, 2012, which was addressed to the floor repair contractor and expressed an interest in retaining the contractor to conduct work on the floors. The memorandum requested that a quote be provided as soon as possible.

The DAB rejected the CAA's arguments citing to the HHS uniform administrative grant requirement that grant recipients "charge to an award only allowable costs resulting from obligations incurred during the funding period."<sup>32</sup> The DAB found that the memorandum had not obligated the repair costs as the contractor had not yet provided a quote for the cost of the job. Since the purchase order and all other support originated in July, 2012, the DAB found that the costs were not obligated until the 2013 program year and should not have been charged to the 2012 program year.

### Lessons Learned:

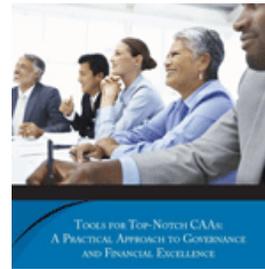
- Proceed with caution in adopting and implementing an incentive compensation policy. Although incentive compensation is an allowable expense under federal awards, federal funding sources carefully scrutinize incentive compensation arrangements to determine whether they meet the detailed requirements for allowability. Charging incentive compensation to a federal award requires, in part, that an organization possess an approved policy and that the policy is consistently applied and followed.
- Work with a qualified professional (such as a lawyer or C.P.A.) who is well-versed in federal funding requirements to develop both a written incentive compensation policy and clear, straightforward procedures for implementing and documenting implementation of the policy in a manner that complies with applicable requirements.
- Document how the criteria in an incentive compensation policy used for evaluating employees was consistently applied. For example, show that incentive compensation paid by percentage of salary is consistent with the amount paid to other similar employees in the organization.
- Determine how the organization will evaluate and document the reasonableness of payments made pursuant to an incentive compensation policy. Work with a qualified professional and refer to prior DAB decisions when making this determination.

- Support costs with records documenting that they were obligated in the budget period in which they will be charged. Examples of adequate documentation are quotes, invoices, purchase orders, check requests, and issued checks that reflect a date within the relevant budget period.

(See endnotes on page 21)

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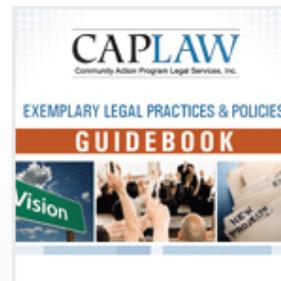
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This six-section toolkit is intended to assist boards and management in their collaborative efforts to build well-governed and effective CAAs. [Learn more and download!](#)

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In the face of ever increasing scrutiny, it's crucial for Community Action Agencies to establish and maintain a strong ethical culture within their organizations, and adopt policies that address applicable requirements.

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# Article End Notes

Circular A-87, Attachment B, ¶ 22.c; 2 C.F.R. § 200.447(c).

6. See 10 C.F.R. § 440.18 (d)(10).

## **Document, Review, Follow & Plan: Lessons Learned from Recent Head Start Disallowances**

1. Kings Community Action Organization, DAB No. 2534 (2013).

2. 42 U.S.C. § 9835(b).

3. 45 C.F.R. § 74.23(a)(5) and § 92.24(b)(1).

4. 45 C.F.R. § 74.23.

5. 42 U.S.C. § 9835(b). See also Administration for Children and Families Program Instruction 12-02, Feb. 2012.

6. 45 C.F.R. § 1301.21.

7. Administration for Children and Families Program Instruction 12-02, Feb. 2012.

8. 45 C.F.R. § 1301.20; 45 C.F.R. § 1301.21.

9. Community Action Partnership of Western Nebraska, DAB No. 2537 (2013).

10. 45 C.F.R. § 74.22(b)(2).

11. 45 C.F.R. § 74.28.

12. Community Action Partnership of Western Nebraska, DAB No. 2537 (2013), citing Cent. Piedmont Action Council, Inc., DAB No. 1916 (2004).

13. 2 C.F.R. Part 230, App. A ¶¶ A.2.a, A.2.g.

14. Suitland Family & Life Dev. Corp., DAB No. 2326 (2010).

15. Cent. Piedmont Action Council, Inc., DAB No. 1916, at 3-4 (2004); Seminole Nation of Okla., DAB No. 1385 (1993).

16. Cent. Piedmont Action Council, Inc., DAB No. 1916, at 3-4 (2004); Seminole Nation of Okla., DAB No. 1385 (1993).

17. Galveston County Community Action Council, Inc., DAB No. 2514 (2013).

18. 2 C.F.R. Part 230, App. A ¶¶ A.2.a, A.2.g.

19. 2 C.F.R. Part 203, App. B ¶ 37.b(1), (2), (7), (8).

20. 45 C.F.R. § 74.21(b)(2)-(b)(3).

21. Although OIG is not typically involved in auditing individual grantees, the OIG was likely called in because of serious concerns by ACF.

22. Texas Neighborhood Services, Inc., DAB No. 2571 (2014).

23. 2 C.F.R. Part 230, App. B ¶ 8.j.

24. 45 C.F.R. § 1301.31.

25. 45 C.F.R. § 74.28.

26. Seaford Community Action Agency, DAB No. 1433 (1993).

27. Washington County Opportunities, Inc., DAB No. 1464 (1994).

28. 2 C.F.R. Part 230, App. A ¶¶ A.2.a, A.2.g.

29. 2 C.F.R. Part 230, App. A ¶A.3.

30. 2 C.F.R. Part 230, App. A ¶A.3.a.

31. Washington County Opportunities, Inc., DAB No. 1464 (1994).

32. 45 C.F.R. § 74.28.

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