



CAA Wins Disallowance Case Involving Statistical Sampling¹

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A decision of the U.S. Department of Health and Human Services (HHS) limits the ability of the HHS Administration for Children and Families (ACF) to use statistical sampling in order to determine the amount of expenses to be disallowed under a grant. Additionally, the decision highlights documentation requirements in regard to expenses charged to a grant: specifically, the need for documentation of contractual obligations.

In this decision, the HHS Departmental Appeals Board (DAB) reversed the disallowance of approximately \$240,000 that Mid-Kansas Community Action Program, Inc. (Mid-CAP) had charged to its Head Start grant. The DAB based the reversal on ACF's improper use of statistical sampling in order to determine the amount to be disallowed. However, the DAB upheld the disallowance of Mid-CAP's \$500 payment to a local public school for utilities, water, trash and janitorial services on the basis that no contract was presented creating an obligation for Mid-CAP to pay.

Background

In compliance with the Single Audit Act,² Mid-CAP had an independent audit conducted which was reviewed by HHS Office of the Inspector General (OIG) and ACF. The audit identified multiple deficiencies and material weaknesses in Mid-CAP's efforts to comply with federal fiscal requirements. At issue in the DAB case was a material weakness involving cash disbursements, i.e., nonpayroll checks, which the auditor found were issued "without proper support and internally required authorization." This finding was based on the auditor's review of 19 individual transactions, of which the auditor found two lacking appropriate documentation. The OIG recommended generally that, based on the "serious nature of weaknesses identified" in the audit, HHS initiate "closer monitoring and increased attention" of Mid-CAP. The OIG also identified material weaknesses and recommendations for each weakness. For the category "cash disbursements," the OIG stated that it "recommends procedures be strengthened to ensure cash disbursements are properly authorized and supported by adequate documentation." However, the OIG did not recommend that any specific costs be disallowed.

ACF then placed Mid-CAP on high risk status resulting in special conditions being placed on grant awards. Following this designation, Mid-CAP and ACF met and corresponded about the problems identified in the audit. In this process, ACF requested, and Mid-CAP provided, all available back-up documentation for the 19 transactions reviewed by the auditors during the preparation of the audit. On the basis that two of the 19 transactions (10.53%) lacked appropriate documentation, ACF disallowed 10% of the total amount of Head Start expenditures reported, approximately \$240,000. One of the two

checks found by the auditor to lack adequate documentation was in the amount of \$500 and was written to a local public school. The DAB requested additional documentation from Mid-CAP regarding this check and was provided with a cancelled check dated December 2006, a voucher marked "PAID", and a contract dated February 2007 indicating that it was for the 2007- 2008 program year. Mid-CAP asserted that this check was a monthly payment for utilities, water, trash, and janitorial services that were necessary for the operation of the program.

Statistical Sampling

The DAB specified that "where a grantee challenges the use of statistical sampling, then the agency"³ must show: (1) that sampling was appropriate in the particular context (in past DAB board decisions this has been shown by demonstrating that individual review of transactions would be impractical due to volume and cost) and (2) that the statistical sampling methodology used was scientifically valid as to the sampling and extrapolation of the results. ACF argued that it would be impractical to review individual transactions on the basis that it would not be practical to evaluate each transaction individually. As support for this assertion, ACF submitted evidence that Mid-CAP had approximately 235 monthly checking transactions.

The DAB rejected this argument on two bases: (1) Mid-CAP's total number of monthly checking transactions, presented as support for ACF's argument, included payroll checks (which were excluded from the initial audit) and (2) this number included non-Head Start transactions. ACF did not demonstrate to the DAB the actual number of transactions that it would have been required to review or that the resulting number of transactions would be impractical due to volume or cost. As a result, the DAB concluded that ACF failed to show that sampling was appropriate in this particular context. Additionally, the DAB rejected ACF's statistical sampling methodology on two grounds: (1) that the selection of transactions examined by the auditors during their audit was not intended as a statistically random sample of Mid-CAP's Head Start transactions; and (2) the method by which the results of the sample were extrapolated to the entirety of Mid-CAP's Head Start expenditures was not appropriate and overstates the result.

Contractual Obligations

For costs to be allowable under federal cost principles, they must be reasonable for the performance of the grant award, allocable thereto, and adequately documented.⁴ Nonprofit recipients of federal funds are required to have a financial management system that provides for records that identify the source and application of funds for HHS-sponsored activities including information pertaining to contractual obligations and accounting records supported by source documentation.⁵ Two of the 19 checks examined by the auditors lacked adequate documentation. One of these checks was in the amount of \$500 to be paid to a local public school. Mid-CAP provided as documentation of this expense: the cancelled check dated December 2006, a voucher marked "PAID," and a contract dated Feb. 2007 for the 2007-2008 program year with the public school for the provision of a classroom and playground space. Mid-CAP asserted that the payment was necessary for the program and that the payment was a monthly payment for utilities, trash, and janitorial services. However, DAB upheld the disallowance of this \$500 expense on the basis that Mid-CAP was unable to provide documentation that the \$500 was paid as a contractual obligation, since the transaction predated the contract provided.

Lessons Learned

- CAAs facing HHS disallowances on the basis of statistical sampling should be aware of the requirements that HHS agencies must meet in order to use sampling as a means of calculating a disallowance.

- Obtain and retain written contracts regarding services to be provided to your CAA, even for small amounts.
- Finally, even though the CAA prevailed in this case, the facts highlight the degree of federal scrutiny of independent audits and how a relatively small number of transactions deemed inadequately documented can result in major problems for CAAs and other federal grantees. As a result, CAAs and other grantees need to be extremely vigilant about documenting transactions.

¹ Complete decision can be found at www.hhs.gov/dab/decisions/DAB2257.pdf.

² The Single Audit Act requires non-profit organizations receiving more than \$500,000 in federal grant funds during a single fiscal year to conduct a comprehensive audit of financial and compliance procedures for their programs for that fiscal year. 31 U.S.C. § 7502(a)(1)(A); Office of Management and Budget Circular A-133 (OMB A-133) (made applicable to non-profits by 45 C.F.R. § 74.26(a)). The \$500,000 threshold is set by regulation. 68 Fed. Reg. 38,401 (June 27, 2003).

³ *Mid-Kansas Community Action Program, Inc.*, DAB No. 2257, at 4 (2009).

⁴ 2 C.F.R. § 230 (codification of OMB A-122). OMB A-122 is applicable to HHS grants to non-profit organizations, including Head Start grantees. 45 C.F.R. § 74.27(a); 45 C.F.R. § 1301.10(a).

⁵ *Mid-Kansas*, DAB No. 2257, at 9 (2009).