Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Child Care Associates
Docket No. A-15-81
Decision No. 2739
September 27, 2016

DECISION

Child Care Associates (CCA) is a Texas non-profit corporation that operates Head Start and Early Head Start programs serving preschool children from low-income families. In addition to its Head Start programs, CCA operates non-Head Start child care programs that are financed with non-federal dollars (including fees charged to parents).

During the period relevant to this case, CCA blended its Head Start and non-Head Start child care programs. This means that the programs shared classroom space, teachers, supplies, and other resources. CCA paid for these shared resources with funds from various sources, including its Head Start grants. The costs incurred (expenditures made) by CCA for the resources shared by its Head Start and non-Head Start programs are referred to herein as "joint costs."

Head Start regulations required CCA to allocate its joint costs among its Head Start and non-Head Start programs in a manner which ensured that each program bore its appropriate share of those costs. An auditor retained by the Administration for Children and Families (ACF) found that CCA failed to allocate joint costs in the required manner during a two-year period that ended on October 31, 2012. Consequently, the auditor reallocated the joint costs from that period (using what it believed to be a proper methodology) and in doing so determined that CCA had overcharged its Head Start awards by $2,544,236. ACF concurred with the auditor's findings and issued a disallowance for that amount. CCA then filed this appeal. During the initial stage of this appeal, ACF reduced the disallowance from $2,544,236 to $2,342,125.

CCA contends in this appeal that its cost allocation practices during the two-year audit period satisfied federal requirements. Alternatively, CCA contends that the auditor's reallocation of joint costs is flawed and proposes adjustments to correct the alleged flaws. The proposed adjustments, CCA says, show that it actually undercharged its Head Start grants – that is, unreported its allowable Head Start expenditures – for the audit period, necessitating a reversal of the entire remaining disallowance.

Based on the evidence of record, we conclude that CCA did not allocate its joint costs in accordance with Head Start requirements during the audit period. In addition, with two minor exceptions, we reject CCA's proposed adjustments to the auditor's cost reallocation. The two adjustments that we approve warrant a reduction of the disallowance by an additional $62,924. Accordingly, we conclude that CCA is subject to a disallowance of $2,279,201 ($2,342,125 minus $62,924) in Head Start funding for the period November 1, 2010 through October 31, 2012.

Legal Background

The Head Start program issues grants to organizations that provide developmental services to children, age three to five, from low-income families. 42 U.S.C. § 9831 *et seq.*; 45 C.F.R. § 1305.4(b), (c). The Early Head Start program issues grants to organizations that provide "low-income pregnant women and families with children from birth to age 3 with family-centered services that facilitate child development, support parental roles, and promote self-sufficiency." 42 U.S.C. § 9840a; 45 C.F.R. § 1304.3(a)(8). (Unless otherwise indicated, we use the term "Head Start" to refer to both grant programs.)

Head Start grantees must (with irrelevant exceptions) comply with the uniform grant administration requirements adopted by the U.S. Department of Health and Human Services (HHS). *See* 45 C.F.R. § 1301.10(a). During the period implicated by the disallowance, the uniform grant administration requirements were found in part 74 of title 45 of the Code of Federal Regulations.[1]

The part 74 regulations require Head Start (and other federal program) grantees to comply with Office of Management and Budget (OMB) Circular A-122. 45 C.F.R. § 74.27(a) (Oct. 1, 2013). OMB Circular A-122, in turn, sets out "cost principles" for determining a non-profit organization's "allowable" costs – that is, grantee costs which may be paid for with federal grant funds.[2] 2 C.F.R. Part 230 (Jan. 1, 2013); *see also Teaching and Mentoring Communities, Inc.*, DAB No. 2636, at 1-2 (2015). In order for a

[1] Effective December 26, 2014, Part 74 was superseded by the "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards" published in 45 C.F.R. Part 75. *See* 79 Fed. Reg. 75,872, 75,875-76 (Dec. 19, 2014). We cite to the Part 74 regulations because they were in effect during the Head Start award periods at issue here.

[2] Until 2014, OMB Circular A-122 was codified in Appendices to 2 C.F.R. Part 230. See 70 Fed. Reg. 51,910 (Aug. 31, 2005); 2 C.F.R. Part 230 (Jan. 1, 2013). This decision cites to, and quotes from, that codification. In December 2013, the OMB consolidated the content of OMB Circular A-122 and eight other OMB circulars into one streamlined set of uniform administrative requirements, costs principles, and audit requirements for federal awards, currently published in 2 C.F.R. Part 200. *See* 78 Fed. Reg. 78,590 (Dec. 26, 2013).

cost to be allowable, it must be (among other things) "allocable to" the grant. 2 C.F.R. Part 230, App. A, ¶¶ A.2.a., A.4.a. A cost is allocable to a grant "in accordance with the relative benefits received." *Id.,* App. A, ¶ A.4.a. Thus, if a cost (an expense incurred by the grantee) confers a "benefit" on more than one "cost objective" – here, the relevant cost objectives are CCA's Head Start and non-Head Start child care programs and their respective funding sources – then the cost must be allocated among those objectives in proportion to the benefit that each cost objective receives as a result of the cost having been incurred. *Teaching and Mentoring Communities* at 2; *see also Univ. of California*, DAB No. 2662, at 2-3 (2015). Overall, the cost principles "are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law." 2 C.F.R. § 230.15 (Jan. 1, 2013); *see also Univ. of California* at 3.

CCA's Child Care Programs

From 2010 through 2012, CCA operated Head Start programs at 38 "child development centers" throughout Fort Worth and Tarrant Counties, Texas. *See* ACF Ex. 1, at 1-2. The Head Start program at each center offered a full day (8 hours for Head Start, 7.5 hours for Early Head Start) of developmental services. *Id.* at 1.

At a majority of its child development centers, CCA operated, in addition to Head Start programs, a full-day, early childhood development program for non-Head Start children. The parties refer to that program as "Child Care." ACF Ex. 1, at 2; Sept. 2, 2015 Affidavit of Patrick Curtis (9/2/15 Curtis Aff.), ¶ 11.

CCA operated its Head Start and Child Care programs in tandem: during regular program hours, Head Start and Child Care students shared the same classrooms, teachers, and instruction. ACF Ex. 1, at 2. According to its Executive Director, CCA "blended" its Head Start and Child Care classrooms in order to improve both programs' services, to "introduce cost savings to both programs by ensuring full classrooms and shared personnel[,]" and to "ensure [that] Head Start children had access to additional Child Care services, including extended child care hours [i.e, "wrap-around day care services," discussed in the next paragraph] for low-income working parents." Supp. Affidavit of Kara Waddell (CCA Attachment H), ¶¶ 5, 9.

In addition to Head Start and Child Care programs, some of CCA's child development centers offered "wrap-around" (Wrap, for short) services. ACF Ex. 1, at 1; 9/2/15 Curtis Aff., ¶¶ 10-11. The Wrap program operated outside of Head Start and Child Care

program hours. ACF Ex. 1, at 1. Wrap services were provided to both Head Start and Child Care children and funded (in whole or part) by fees charged to children's parents.[3] *Id.* at 1, 2. A center's Wrap program operated for 3 to 3.5 hours per day. *Id.* at 1; 9/2/15 Curtis Aff., ¶ 23.

Several of CCA's child development centers had partnerships with Texas independent school districts (ISDs). ACF Ex. 1, at 1; 9/2/15 Curtis Aff., ¶ 11. Under those partnerships, CCA provided Head Start services to children in classroom space provided by the ISDs and staffed in part with ISD teachers and teaching assistants. 9/2/15 Curtis Aff., ¶ 11. (CCA treated the ISD resources as in-kind donations to its Head Start programs. *Id.*, ¶¶ 24, 27; ACF Ex. 1, at 4 n.3.)

At each of its child care development centers, CCA incurred joint costs – that is, costs whose benefits were shared by its Head Start and non-Head Start programs. For example, CCA paid salaries or wages of teachers and teaching assistants whose classes consisted of both Head Start and Child Care children. CCA admits that its child care program costs were "allocable to multiple cost objectives" (those objectives being its Head Start, Child Care, and Wrap programs) and therefore needed to be allocated in accordance with the federal cost principles. *See* CCA's Jan. 19, 2016 Reply to the Agency's Brief in Support of Disallowance (CCA Reply Br.) at 10.

Audit, Disallowance, and Appeal

During December 2014, Rubino & Company, an accounting firm retained by ACF, audited how CCA had allocated joint costs among its child care programs during the two-year period ending on October 31, 2012. ACF Ex. 1, at 1. Rubino concluded that CCA "did not allocate joint costs in proportion to the benefits received by each program." *Id.* at 2. In order to measure the impact of that alleged deficiency, Rubino reallocated CCA's joint costs using what it said were "appropriate allocation bases and methodologies." *Id.* at 3. Based on that reallocation, Rubino determined that CCA had "overcharge[d]" its Head Start grant awards by $2,544,236 for the two-year period ending October 31, 2012.[4] *Id.* at 1. Rubino reported its audit findings to ACF in a March 31, 2015 memorandum

---

[3] ACF's auditor assumed, and CCA does not dispute, that CCA's costs of delivering Wrap services could not be charged to its Head Start grants because those services did not meet the Head Start Program Performance Standards in 45 C.F.R. Part 1304. ACF Ex. 1, at 2.

[4] The Head Start grants implicated by Rubino's audit findings are identified as award number 06CH0021/36 (covering the period from November 1, 2010 through October 31, 2011) and award number 06CH0021/37 (for the period November 1, 2011 through October 31, 2012). ACF Ex. 1, at 8.

authored by its lead auditor, Patrick J. Curtis, Jr. *Id.* at 1. Based on Rubino's findings, ACF disallowed $2,544,236 of CCA's Head Start expenditures for the period November 1, 2010 through October 31, 2012. *See* June 5, 2015 Notice of Disallowance.

In July 2015, CCA filed this appeal and asked ACF to produce information and documents that it said it needed to evaluate Rubino's audit findings. In response, ACF produced numerous exhibits containing spreadsheets, cost summaries, and other material reflecting Rubino's audit work. ACF also proffered the September 2, 2015 affidavit of Patrick Curtis. That affidavit outlines, in extensive detail, Rubino's findings regarding CCA's cost allocation practices and explains how Rubino reallocated CCA's joint costs and calculated the alleged overcharge to CCA's Head Start grants.

The Curtis affidavit indicates that after ACF issued the disallowance, Rubino modified its approach to allocating CCA's fringe benefit costs and as a result determined that the alleged overcharge to Head Start was $202,111 less than originally reported. *See* 9/2/15 Curtis Aff., ¶¶ 46-48. Accordingly, ACF notified the Board, in a September 10, 2015 "Statement of Clarification," that it was reducing the disallowance by $202,111 – from $2,544,236 to $2,342,125. ACF indicated in that submission that it concurred with Rubino's analysis and findings in all other respects.

After ACF produced the requested audit materials, the parties submitted briefs. CCA's opening brief was accompanied by numerous exhibits and "attachments," including employee affidavits and a report authored by Carr, Riggs & Ingram LLC (CRI), an accounting firm retained by CCA to review Rubino's work. In addition, CCA proffered the affidavit of J. Michael Maddox, a CRI partner and certified public accountant.

After the initial round of briefing, CCA requested an evidentiary hearing. Deferring a ruling on that request, the Board issued an Order to Develop the Record. In that order, the Board directed ACF to respond to certain arguments presented by CCA and directed both parties to respond to questions. ACF's response to the Board's order consisted of a second affidavit from Patrick Curtis (dated April 29, 2016), to which ACF attached 102 pages of documents. CCA filed its response to the Board's order 13 days after ACF filed its response. CCA's response included documentary evidence and supplemental affidavits from J. Michael Maddox and others.[5]

[5] CCA's "exhibits" are cited herein as "CCA Ex." and its "attachments" as "Att." ACF's exhibits are cited as "ACF Ex." The parties' briefs are cited as follows: Dec. 4, 2015 Brief of the Appellant ("CCA Br."); Jan. 4, 2016 ACF Brief in Support of Disallowance ("ACF Resp. Br."); Jan. 19, 2016 CCA Reply to the Agency's Brief ("CCA Reply Br."); May 23, 2016 CCA Response to the Board's Order to Develop the Record ("CCA Resp. to Order").

CCA's Contentions on Appeal

In objecting to the disallowance, CCA contends that it properly allocated joint costs among its Head Start, Child Care, and Wrap programs during the two-year audit period. CCA Br. at 12-13; CCA Reply Br. at 6-8. Rubino's contrary finding, says CCA, reflects a misunderstanding of its child care programs and cost allocation practices. CCA Br. at 10; CCA Reply Br. at 3, 5, 6-7. In addition, CCA argues that Rubino's reallocation of the joint costs violates federal cost principles. CCA Br. at 9-12; CCA Reply Br. at 8-13. CCA contends that if the alleged flaws in Rubino's work are corrected, CCA will be found to have undercharged its Head Start grants for the two-year audit period. CCA Br. at 6, 12; CCA Reply Br. at 13-14.

Ruling on Pending Motion

Before discussing the merits of CCA's appeal, we dispose of CCA's outstanding request for an evidentiary hearing. The regulations in 45 C.F.R. Part 16 state that the Board will hold an evidentiary hearing "if it finds there are complex issues or material facts in dispute the resolution of which would be significantly aided by a hearing." 45 C.F.R. § 16.11(a). Although the record reveals some facts to be in dispute, the factual disputes are immaterial, or, if they are material, we have resolved them in favor of CCA for purposes of our analysis. In addition, the issues in this case are not unduly complex and are capable of being resolved by straightforward application of well-established legal principles. For these reasons, we deny CCA's request for an evidentiary hearing.

Discussion

CCA's appeal raises two basic issues: first, did CCA properly allocate its joint costs during the two-year audit period? Second (and assuming the answer to the first question is no), is there any basis to find that Rubino's cost reallocation (and resulting disallowance calculation) requires adjustment to ensure that Head Start bears its appropriate share of CCA's joint costs?

We answer those questions in accordance with the applicable evidentiary standards. In disallowance appeals, a grantee "bears the burden of demonstrating the allowability and allocability of costs for which it received federal funding." *Bright Beginnings for Kittitas County*, DAB No. 2623, at 5 (2015); *see also Council for Econ. Opportunities in Greater Cleveland*, DAB No. 1980, at 9 n.11 (2005) (stating that, "[i]n general, the burden is on a recipient of federal grant funds to justify both the allowability of its costs, and the methods used to allocate those costs to its federal awards"). When a disallowance is based on audit findings, the grantee typically has the "burden of showing that those findings are legally and factually unjustified." *E Center*, DAB No. 2657, at 2 (2015) (internal quotation marks omitted).

A. *CCA failed to show it complied with federal cost principles in allocating joint costs.*

During 2011 and 2012, CCA pooled all joint costs – costs whose benefits were shared by its Head Start, Child Care, and Wrap programs – in a single Head Start cost center. Att. K, ¶ 31. Then, using a "child care reclass journal entry," CCA reclassified – or carved out – a portion of the pooled costs that it "estimated" were allocable to the Child Care and Wrap programs. *Id.*; Att. D, ¶¶ 9 10; Att. G, ¶ 13; *see also* 9/2/15 Aff. ¶ 12. The pooled costs which remained after this reclassification were those that it charged to its Head Start grants. *See* Att. G, ¶ 12 ("A credit for the portion of . . . expenses allocated to Child Care and Wrap services was taken [via reclass journal entry] when calculating amounts for Head Start and Early Head Start to be drawn down from" HHS's Payment Management System).

CCA explained that the amount of the reclass journal entry was calculated by multiplying "actual attendance" in its Child Care and Wrap programs by a weekly rate applicable to each program. Att. G, ¶ 14; Att. D, ¶ 10; Att. K, ¶ 51; *see also* 9/2/15 Curtis Aff., ¶ 13. The weekly rates were "derived from informal surveys" of child care rates charged by other child care providers in the surrounding community. Att. D, ¶ 10; Att. G, ¶ 15; Att. H, ¶ 10 (stating that its allocation method was based in part on "market rates for child care centers").

The critical issue raised by these practices – and addressed by ACF's auditor – is whether they served to allocate CCA's joint costs in accordance with relative benefits received, as the cost principles in OMB Circular A-122 require. Costs that benefit more than one program "must be allocated to each program in proportion to the benefits that each derives from the activity that generated the costs." *Ohio Dept. of Job & Family Servs.*, DAB No. 2643, at 5 (2015).

Acknowledging this requirement, CCA cites 45 C.F.R § 75.405.[6] CCA Resp. to Order at 13. Section 75.405 summarizes the relevant cost principle this way:

> If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more

[6] Section 75.405 is part of the recently promulgated "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards," which recently supplanted OMB Circular A-122, other OMB Circulars, and 45 C.F.R Part 74. *See* 79 Fed. Reg. 75,872, 75,875-76 (Dec. 19, 2014).

> projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then . . . the costs may be allocated or transferred to benefitted projects on any reasonable documented basis.

45 C.F.R. § 75.405(d). CCA also points to ACF's "Cost Allocation Narrative." CCA Response to Order at 12. This Head Start program guidance elaborates further on the requirement to allocate costs in accordance with relative benefits received:

> Cost allocation means the process of assigning to two or more programs the costs of an item shared by the programs. The goal is to ensure that each program bears its fair share, and only its fair share, of the total cost of the item.
>
> * * *
>
> The requirement to allocate the costs of shared resources can be met by using *logical and rational methods to ensure that each program is paying only its fair share* of the cost of an item used in common, and that no program is subsidizing another. Generally, the *methods used to allocate a shared cost should be the simplest, most straightforward way of allocating this type of cost fairly*. Complex, highly detailed methods should be avoided when a simple one will achieve the objective.
>
> Methods, rules or formulas that use percentages or fractions of cost items are acceptable. For example, a method of allocating staff costs could be as simple as a statement of the percentage of time attributable to a funding source. If an individual spends half of the day on Head Start activities, another 25 percent on activities supported by funding source A and 25 percent on activities supported by funding source B, then the cost allocation rule is 50 percent to Head Start, 25 percent to funding source A, and 25 percent to funding source B. These percentages may then be applied to all relevant personnel costs for that individual (or group of individuals) for a budget period. Minute-by-minute, hour-by-hour allocation is not required, *but there must be a way to reasonably establish the basis for the allocation rule*, such as agency or classroom schedules or prior year reports.
>
> Each of the major "cost centers" or cost items in the agency's budget should be looked at for a reasonable, fair way to allocate the costs of that shared resource. The method for allocating the cost of facilities (office space, for example) may be quite different than the method for staff, but still expressed in simple percentage terms. For example, an agency could

> analyze the space (expressed in square feet) used in the administration of various programs. If the Head Start director and secretary use 200 square feet in an agency's headquarters building with a total of 2,000 square feet, then Head Start's fair share of that space's cost is 10 percent (200/2,000). Other cost items would be analyzed in similar terms, using *appropriate measures* for each.
>
> *The nature and use of each cost item determines the most suitable measure for that item and the best scheme for the allocation of costs.*

CCA Ex. 29 (italics added).[7]

Section 75.405 and the Cost Allocation Narrative express or illustrate two basic principles. First, in order to properly allocate the cost of a shared resource, the grantee must select an appropriate "base" – e.g., use or consumption of the resource, or some other logical or rational factor – by which to measure the benefits conferred by the cost on each cost objective. *Cf.* 2 C.F.R. Part 230, App. A, ¶ D.4.b. (stating that a joint cost should be "prorated using a base which accurately measures the benefits provided to each award"); *id.*, App. A, ¶ D.3.c. (stating that an "essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither the cause nor the effect of the relationship is determinable"). Second, the allocation method's reasonableness must be adequately documented. *Cf. id.*, App. A, ¶ D.4.b. (allocation "bases must be established in accordance with reasonable criteria, and be supported by current data"). The Board has applied both principles and required that grantees document the reasonableness of their cost allocation methodologies. *See, e.g., Teaching and Mentoring Communities* at 9-10 (holding that pooled costs needed to be allocated using a factor that produced a "reasonable measure of the relative benefits conferred" on the grantee's programs, and explaining that relative benefits are determined using some method for measuring "the extent to which an organization's programs or activities . . . . use or consume shared resources"); *S.E. Mich. Health Assoc.*, DAB No. 2682, at 3 (2016) (noting that a grantee's evidentiary burden in a disallowance appeal includes "demonstrating that its allocation methodology was reasonable") (internal quotation marks omitted); *N.H. Dept. of Health & Human Servs.*, DAB No. 2399, at 6-7 (2011) (stating that a pool of costs must be distributed to programs that benefit from the costs using some "formula or procedures that can be expected to reasonably capture the relative benefits").

---

[7] ACF's Cost Allocation Narrative is also available at https://eclkc.ohs.acf.hhs.gov/hslc/tta-system/operations/mang-sys/fiscal-mang/Cost%20Allocation.htm .

CCA has failed to show that it complied with the requirements we have just described. As noted, CCA pooled its joint costs in a "Head Start" cost center, then reclassified (carved out) a portion of those pooled costs as Child Care and Wrap costs. At minimum CCA needed to show that it determined the Child Care and Wrap programs' share of the pooled costs based on a reasonable determination of the degree to which each program (Head Start, Child Care, and Wrap) benefited from the entire pool of costs. CCA has not done so. Indeed, CCA does not plainly state, in its briefs or affidavits, that its cost reclassification procedure was intended or designed – or actually functioned – to allocate costs in proportion to benefits received. Assuming that CCA intended to allocate costs based on benefits received, CCA fails to explain why its methodology was appropriate given the actual conditions under which its programs operated, the type of costs to be allocated, and the nature of the "benefits received." *Cf.* 2 C.F.R. Part 230, App. A, ¶ D.3.c. (stating, with respect to "indirect costs," that "*[a]ctual conditions* shall be taken into account in selecting the base to be used in allocating" those costs (italics added)); *East Mo. Action Agency, Inc.*, DAB 1802, at 6 (2001) (stating that the "nature of the cost being allocated is paramount" in determining the "nature of the benefits received").

Teresa Williamson, who served as CCA's controller during the relevant period, stated in an affidavit that the "child care reclass entry" – meaning the amount of joint costs that CCA determined to be allocable to the Child Care and Wrap programs (as opposed to Head Start) – "approximat[ed] the costs of operating a private pay child care service." Att. D, ¶ 10; *see also* Att. G, ¶ 15; Att. K, ¶ 51. That statement does not tell us how, if at all, CCA sought to measure *relative benefits* conferred by its joint costs. According to Williamson, CCA merely estimated what it would have cost CCA to serve Child Care and Wrap clients had it operated those programs as a "private pay child care service" (independently from its Head Start programs). That estimate reveals nothing about the extent to which each program (Head Start, Child Care, and Wrap) benefited from joint costs that CCA actually incurred.[8]

---

[8] CCA suggests that its approach to allocating costs is appropriate given that the Head Start program achieved cost savings as a result of being run jointly with the Child Care program. CCA Reply Br. at 15; CCA Resp. to Order at 7. CCA points to evidence that after it ceased operating the Child Care program, its cost of serving a Head Start child rose from $8,284 (in 2010 and 2011) to $9,738 (in 2015 and 2016). CCA Resp. to Order at 7 (*citing* Att. K, ¶¶ 12-13). CCA contends that, had it continued operating the Child Care program after 2012, its cost of serving a Head Start child would have been $8,592 in 2015 and 2016 (rather than $9,738). *Id.* at 7, 12. According to J. Michael Maddox, the CRI accountant, CCA's intent was "to provide child care services to a larger number of children while providing net savings to the Head Start/Early Head Start programs through efficiencies and shared costs." Att. G, ¶ 15. Whether Head Start enjoyed cost savings as a result of its partnership with the Child Care and Wrap programs is irrelevant because an analysis or estimate of cost savings is not itself a method for allocating joint costs according to relative benefits received, and because CCA does not explain what the alleged cost savings reveal about the relative benefits conferred by the joint costs that it actually incurred.

Although CCA does not clearly state how it measured relative benefits, Rubino understood CCA to have used "head count" – that is, attendance for each program – as an allocation base. *See* 9/2/15 Curtis Aff., ¶¶ 18-20. Rubino found that a head-count method "likely overstated" the costs allocable to Head Start because the Child Care program's share of joint costs was calculated based on actual attendance of that program's students, whereas Head Start's share reflected "funded" (as opposed to actual) enrollment. *Id.*, ¶¶ 18-19. Rubino also found that head count was an insufficiently accurate criterion for measuring relative benefits because it masked the fact that some costs were driven by the number of hours that a program operated. *Id.*, ¶ 23 ("The use of head count assumed that each service requires the same level of input from cost drivers. Based strictly on the hours of service associated with each activity, it was clear that not all classes of services [not all programs] receive the same benefit from cost drivers."). CCA does not respond to either criticism. It also takes no issue with Rubino's finding that CCA's method failed to allocate facility-related costs – a significant category of costs given that CCA's programs were operated out of shared classrooms – to the Child Care and Wrap programs. *See* ACF Ex. 1, at 2; 9/2/2015 Curtis Aff., ¶ 13; 4/29/2016 Curtis Aff., ¶ 62.

In addition, CCA failed to establish the basis for, or reasonableness of, its cost rates. As noted, CCA calculated the Child Care and Wrap programs' share of joint costs based on rates (multiplied by program attendance) that were supposed to represent CCA's weekly costs of serving those programs' clients. *See* Att. G, ¶¶ 14-15 (noting that "reclass process . . . was formulated with the intent of crediting Head Start and Early Head Start for the entire cost of operating the Child Care and Wrap programs"); Att. K, ¶ 51 (stating that CCA's methodology was "designed to carve out fully burdened costs" of serving Child Care children). But the rates were not, as CCA admitted, based on an analysis of its *own* costs; rather, the rates were based on market child care rates charged by other organizations in the surrounding community. Att. G, ¶ 15; CCA Response to Order at 6-7 (asserting that "reclassifications were based on market rates of child care services/facilities . . . in the area as the factor for cost determination" rather than a "cost approach"). CCA proffered no legal or accounting justification for not using its own cost data to calculate the rates. Furthermore, except for a single page of cryptic handwritten notes (CCA Ex. 4), CCA did not explain how it calculated the rates or show that they fairly approximated its actual costs of serving Child Care and Wrap clients.[9] CCA suggests that the rates overstated its actual costs of providing Child Care and Wrap services and thereby favored the Head Start program. CCA Response to Order 6-7. CCA offered no analysis to back up that assertion, however.

[9] Patrick Curtis, Rubino's accountant, stated in his second affidavit that CCA's former controller, Teresa Williamson, "was unable to explain the source" of the rates. 4/26/2016 Curtis Aff., ¶ 56. Williamson does not respond to that assertion in her supplemental affidavit (Att. H).

CCA asserts that it allocated costs in accordance with generally accepted accounting principles (GAAP). *See* Response to Order at 2-3. To support that assertion, CCA relies on the supplemental affidavit of J. Michael Maddox. *Id.* (citing Att. K, ¶¶ 36-40). Maddox, in turn, points to a section of the Financial Accounting Standard Board's *Accounting Standards Codification* (ASC)[10] which indicates that a "Standalone Joint Cost Allocation Method" may, in appropriate circumstances, be an acceptable method of allocating joint costs. Att. K, ¶¶ 37-39 (citing CCA Ex. 31). Maddox stated that CCA's cost allocation procedures "met the requirements" of GAAP, implying (albeit vaguely) that CCA had allocated joint costs using the standalone method or some variation of that method. *Id.*, ¶ 40. However, Maddox did not explain what calculations or cost analysis the standalone method requires in order to be acceptable or specify the circumstances in which the use of that method might be appropriate. Nor does he point to evidence that CCA actually used that method.[11]

In its order to develop the record, the Board expressly asked CCA to show that it had allocated costs in accordance with relative benefits received. *See* CCA Response to Order at 3. In response, CCA did not discuss its apparent allocation methodology (multiplying program attendance by the cost rates derived from market rates for child care services) or show that its cost reclassification entries reflected some measurement of relative benefits received by its programs. Instead, CCA suggested that its allocation methodology is reasonable because it produced allocations that are comparable to the allocable shares calculated by Rubino, *once those shares are adjusted, as CCA proposes*, to account for the "impact of varying wage and staffing requirements" of the Head Start and Child Care programs. Att. K, ¶ 42. However, a grantee cannot establish the reasonableness of its allocation methodology merely by comparing its results to those obtained by other methods. Instead, the grantee must demonstrate that *its* methodology was designed and implemented to produce equitable results (in accordance with relative benefits received). In any event, the linchpin of this argument – CCA's claim that Rubino's results require adjustments to account for "varying wage and staffing requirements – is unsound. As we discuss in the following sections, those adjustments are neither required nor appropriate under the cost principles.

---

[10] The ASC is an authoritative source of generally accepted accounting principles for nongovernmental organizations. *MHC Mutual Conversion Fund, L.P. v. United Western Bancorp, Inc.*, 913 F. Supp. 2d 1026, 1034 n.5 (D. Colo. 2012), *aff'd*, *MHC Mutual Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P.*, 761 F.3d 1109 (10th Cir. 2014).

[11] The standalone method appears to require an estimate of the cost that each "component" (that is, each user or beneficiary) of a joint activity *would incur* if that activity had been performed independently for each component. Joint costs are then allocated to a component according to a ratio that equals that component's estimated stand-alone cost divided by the sum of the estimated stand-alone costs to all components. *See* CCA Ex. 31. We make no finding here about whether or under what circumstances the "standalone method" might be appropriate for Head Start cost allocation purposes.

To summarize, the cost principles in OMB Circular A-122 required CCA to allocate joint costs in accordance with relative benefits received. In response to an audit finding questioning its compliance with that requirement, CCA failed to show that it allocated joint costs based on some appropriate measure or estimate of the relative benefits conferred by those costs on its Head Start, Child Care, and Wrap programs. Accordingly, a reallocation was necessary to ensure that Head Start bore its appropriate share of CCA's joint costs.

B. *With two minor exceptions, CCA has failed to establish that Rubino's reallocation of joint costs requires adjustment.*

We next consider CCA's objections to the reallocation of its joint costs from the two-year audit period. We begin by describing, in general terms, how that reallocation was performed.

1. <u>Method of reallocation</u>

In analyzing CCA's costs, Rubino distinguished between Head Start programs operated at CCA's owned or leased child care centers, and Head Start programs that CCA operated from space donated by independent school districts (ISDs). 9/2/15 Curtis Aff., ¶¶ 1, 24. Rubino used the following acronyms to identify CCA's programs: HS (Head Start); HS-ISD (Head Start programs operated in ISD-donated space); EHS (Early Head Start); and CCW (Child Care and Wrap programs, which Rubino combined into a single category in order to simplify its analysis). *Id.*, ¶ 26.

Because CCA's programs operated for differing lengths of time – 8 hours for Head Start and Child Care, 7.5 hours for Early Head Start, and 3 to 3.5 hours for Wrap – Rubino decided that a 'gross hours of service model" was "the best way to estimate the relative benefits provided to each class of service [i.e., to each program]." *Id.*, ¶ 23; *see also* ACF Ex. 1, at 2; 4/29/2016 Curtis Aff., ¶ 16. To determine the "appropriate set of [allocation] bases" using this model, Rubino began by estimating "average daily attendance" for each child care center's programs. 9/2/15 Curtis Aff., ¶¶ 17, 20-21; ACF Ex. 1, at 3. Based on its attendance estimates, Rubino calculated each center's gross hours of service for each program for each year. 9/2/15 Curtis Aff., ¶ 25.

Next, Rubino examined "center level cost reports" to "examine the nature of costs accumulated at the center levels." *Id.*, ¶ 27. For each relevant year, Rubino grouped a center's costs to create four "direct cost" pools:

- Pool A ("center director and basic supplies")
- Pool B ("facilities")

- Pool C (“classroom instruction”)
- Pool D (“Head Start-specific costs”)

Id., ¶¶ 27, 32.

“Based on discussions with management,” Rubino determined that: (1) Pool A costs benefited all CCA programs (HS, HS-ISD, ESD, and CCW) to approximately the same degree; (2) Pool B costs (“facilities”) benefited all CCA programs equally except for HS-ISD, which derived no benefit from Pool B costs because that program operated from ISD-donated space; (3) Pool C costs (for “classroom instruction” – mainly the wages of teachers and teacher’s aides and associated taxes and fringe benefits) benefited all CCA programs to the same degree except for HS-ISD, which received only 50 percent of the benefits from Pool C costs because ISDs had donated 50 percent of that program’s teachers and teaching assistants; and (4) Pool D costs (Head Start-specific costs) were assumed to benefit only the HS, HS-ISD, and EHS programs. *Id.*, ¶¶ 27, 24.

Next, for each center, Rubino calculated percentages representing the degree to which its programs participated in each of the “direct cost” pools created by Rubino. 9/2/15, ¶ 28; ACF Ex. 1, at 3-4. The participation percentages reflected gross hours of service and were adjusted, when necessary, to account for the fact that a program did not share, or fully share, in the benefits conferred by a pool’s costs. 9/2/15 Curtis Aff., ¶ 28; ACF Ex. 1, at 4 & Table 4. The participation percentages were then applied to apportion the pooled costs among each of the center’s programs. 9/2/15 Curtis Aff., ¶ 32. (An illustration of this process appears in Rubino’s March 31, 2015 memorandum to ACF. ACF Ex. 1, at 5-8.)

In addition to determining each program’s allocable share of direct costs (via the process we have just described), Rubino calculated a program’s allocable share of indirect costs in accordance with CCA’s approved indirect cost rate agreements. 9/2/15 Curtis Aff., ¶¶ 33-35; ACF Ex. 1, at 6. According to Rubino, CCA captured indirect costs for all child care centers in a single pool (labeled “HS admin”). 9/2/15 Curtis Aff., ¶ 14. Under CCA’s indirect cost agreements with HHS, the “base” for allocating those pooled costs was direct salaries and wages, including all fringe benefits. *Id.*, ¶ 35. Hence, for each program (at each center), Rubino applied the negotiated indirect cost rate to the program’s allocable share of direct salaries, wages, and fringe benefits in order to determine that program’s allocable share of indirect costs. ACF Ex. 1, at 6-7.

For each year audited, Rubino totaled – across all of CCA’s centers – the direct and indirect costs that it found were allocable to CCA’s Head Start programs (HS, HS-ISD, and EHS). 9/2/15 Curtis Aff., ¶ 39. Rubino then compared the organization-wide totals to the amounts reported as the “federal share” of Head Start program expenditures on

CCA's annual Financial Status Reports (form SF-425) in order to quantify the amount of any over- or under-allocation of costs to its Head Start awards.[12] *Id.*, ¶¶ 40-42, 46-48; ACF Ex. 1, at 6-7.

In short, Rubino determined each program's allocable share of joint costs based on the program's aggregate hours of service, as adjusted to reflect a program's operational relationship to certain pools (categories) of costs. CCA does not contend that this approach is conceptually flawed or that it was inadequately implemented. Nonetheless, CCA contends that the reported *results* of Rubino's allocation must be adjusted in certain ways to ensure that Head Start and non-Head Start programs received their fair share of joint costs. We consider these proposed adjustments in sections B.2 through B.6, below.

2. Head Start-Child Care "wage differential"

CCA contends that Child Care's allocable share of joint costs (as calculated by Rubino) must be reduced to account for an alleged disparity between the salaries paid to Head Start teachers and teaching assistants, and the salaries paid to "childcare workers" who instruct, or attend to, preschool children outside the Head Start program. CCA Ex. 1, at 1-4. This contention flows from CCA's comparison of teacher qualification requirements under federal (Head Start) and state law.

The Head Start Act (Act) requires ACF to ensure (on specified timetables) that center-based Head Start and Early Head Start teachers and teaching assistants meet minimum academic and "alternative credentialing and degree" requirements. *See* 42 U.S.C. §§ 9840a(h), 9843a(a). It is unnecessary to delve into the considerable details of these requirements. In general, the Act calls for ACF to ensure that: (1) at least 50 percent of Head Start classroom teachers hold a baccalaureate or advanced degree in early childhood education or a baccalaureate or advanced degree in an unrelated field coupled with coursework in early childhood education; and (2) Head Start teaching assistants have at least a "child development associate credential" or be enrolled in a "child development associate credential program" or a program "leading to an associate or baccalaureate degree." 42 U.S.C. § 9843a(a)(2)(A), (a)(2)(B)(ii). In addition, the Act requires ACF to ensure that Early Head Start teachers "providing direct services to children and families" have a "child development associate credential" plus training or equivalent coursework in early childhood development. *Id.* § 9840a(h)(1).

[12] These calculations reflect certain "fixed asset" adjustments about which CCA has not raised any issue. *See* 9/2/15 Curtis Aff., ¶¶ 40-42.

Section 741.1107 of title 40 of the Texas Administrative Code imposes minimum academic requirements for "caregivers" employed by licensed "child-care centers." In general, section 741.1107 provides that Texas caregivers must have a high school diploma (or some equivalent credential) and complete eight hours of pre-service training. These requirements on their face appear less demanding than Head Start's academic and credentialing requirements for teachers and teaching assistants, so we assume they are for purposes of our decision. We also assume that section 741.1107 was applicable to CCA's Child Care and Wrap programs during the relevant two-year period.

CCA posits that if it had operated the Child Care program in a "stand-alone setting" (independently of its Head Start program), instead of serving Head Start and Child Care clients together in the same classrooms, there would have been no (or lesser) need for it to hire teachers and teaching assistants that met Head Start's academic and credentialing requirements. In that circumstance, CCA, as a matter of "sound business practices," would have staffed the Child Care program with comparatively less qualified "caregivers" (who needed no more than a high school-level education) and paid them less than it paid the teachers and teaching assistants who actually staffed its blended Head Start-Child Care classrooms. *See* CCA Ex. 1, at 4. Accordingly, CCA submits that it is necessary to adjust "base salary costs allocable to Child Care" for the "differential between [the] average [actual] Head Start/Early Head Start" hourly wage paid to its teachers and teaching assistants, and its estimate of the average hourly wage for non-Head Start "childcare workers" in CCA's service area. *Id.* (italics added).

CCA calculated that the average, blended hourly wage for its Head Start teachers and teaching assistants was $10.51 during the relevant two-year period. CCA Ex. 1, at 5, 17. In addition, relying on BLS occupational classifications and wage data, CCA estimated that the average hourly wage for childcare workers in the Fort Worth-Arlington (Texas) metropolitan area was $9.42 during the same period. *Id.* Based on these figures, CCA determined that there was a Head Start "wage premium" of 10.33 percent in its service area. *Id.* at 4, 17. Applying that percentage to the Child Care program's share of base salary costs (as calculated by Rubino), CCA asserts that Rubino overstated Child Care's allocable share of teacher and teaching assistant salaries by $262,578 and that the disallowance should correspondingly be reduced by that amount. *Id.* at 4.

We reject this proposed adjustment, primarily because it ignores the principle that joint costs be allocated in accordance with relative benefits *received* by its Head Start and Child Care programs. As we said, CCA does not point to any flaw in Rubino's decision to use gross hours of service (as adjusted to account for a program's operational relationship to certain direct cost pools) as the yardstick for measuring relative benefits

received by each program from CCA's joint (direct) costs. The adjustment proposed by CCA does not establish an alternative basis for measuring relative benefits. Nor does the adjustment purport to correct errors by Rubino in implementing its chosen methodology. CCA merely proposes to adjust the results of Rubino's work without showing that the adjustment would make Rubino's measurement of relative benefits more rational or accurate.

Moreover, CCA's proposal rests on a hypothesis (a cost estimate for a Child Care program operated independently of Head Start) that does not reflect the actual conditions under which CCA operated. Rubino assumed that CCA's Head Start programs (excluding those operated in partnership with ISDs) and Child Care programs obtained equal benefit from salary costs incurred by CCA to staff its classrooms. That assumption is plainly reasonable given that Head Start and Child Care students were taught and supervised simultaneously in the same classrooms by the same teachers and teaching assistants. Rubino's equal-benefit assumption is consistent with the stated objective of CCA's decision to "blend" its Head Start and Child Care programs. According to CCA's Executive Director, the objective of blended classrooms was to "create efficiencies for both" programs and help ensure that all preschool children – Head Start-eligible or not – received high-quality instruction and care. CCA Att. H, at 6-7, 9 (italics added). The adjustment proposed by CCA would undercut the equal-benefit assumption[13] and, thus, it appears, CCA's own objective in blending its programs. If CCA thinks there is a discrepancy between Rubino's equal-benefit assumption and its own objectives in blending its Head Start and Child Care programs, it does not explain why that is the case. Nor does CCA explain its understanding of "benefits received," indicate why it thinks

[13] In effect, CCA contends that because it would pay a teacher in some hypothetical Child Care-only classroom 10.33 percent less than it actually paid a teacher to staff a blended Head Start-Child Care classroom, a Child Care student in the blended classroom should be regarded as having received 10.33 percent less benefit from classroom activity than a fellow Head Start student in same classroom.

Rubino's methodology failed to accurately measure those benefits, or explain how a hypothetical wage differential can be thought to measure the benefits conferred by the salary costs that it actually incurred to staff its blended classrooms.[14]
CCA points to a provision of OMB Circular A-122 that specifies factors for judging whether costs incurred by a grantee are "reasonable" – factors that include "restraints or requirements imposed by . . . *arms length bargaining*[.]" *See* 2 C.F.R. Part 230, App. A, A.3.b (italics added). CCA asserts that "a prudent person *negotiating an arms-length transaction* for shared child care facilities and costs would not be expected to share personnel costs at a rate exceeding that which could be secured in a stand alone setting." CCA Ex. 1, at 4.

There is no merit in that argument. The reasonableness of CCA's costs is not at issue. There was, to be more specific, no finding by ACF that CCA's salaries for teachers and teaching assistants exceeded "that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur" those costs. 2 C.F.R. Part 230, App. A, ¶ A.3. The relevance of arms-length negotiation also escapes us. Such negotiation presupposes the involvement of two unrelated entities each

---

[14] Even if we thought that a hypothetical wage differential was some indicator of relative benefits received, we would reject the proposed adjustment because CCA failed to show that the wage differential it calculated was based on appropriate data and assumptions. To calculate the differential, CCA compared the average (blended) hourly wage of its Head Start teachers and teaching assistants to its estimate of the average hourly wage for workers who fall within Standard Occupational Classification 39-9011, titled "Childcare Workers." See CCA Ex. 1, at 5; 4/29/16 Curtis Aff., ¶ 6; CCA Ex. 26. BLS defines the work of "childcare workers" as follows:

> Attend to children at schools, businesses, private households, and childcare institutions. Perform a variety of tasks, such as dressing, feeding, bathing and overseeing play. Excludes "Preschool Teachers and Teachers Assistants, Except Special Education" (25-2011) and "Teacher Assistants" (25-9041).
>
> *Illustrative examples: Au Pair, Daycare Provider, Nanny*

ACF Ex. 26. We accept that a hypothetical Child Care program, operating independently from Head Start, might employ workers who fall into this occupational category. However, given that "age-appropriate education" is one of the services that CCA provides to Child Care recipients, *see* Att. A (description of "Child Care Services"), there is at least one other occupational classification from which a Child Care program might possibly draw employees – namely, "Preschool Teachers" (SOC No. 25-2010), whose work is defined by the BLS as follows:

> Instruct preschool-aged children in activities designed to promote social, physical, and intellectual growth needed for primary school in preschool, day care center, or other child development facility. May be required to hold State certification. . . . Excludes "Childcare Workers" (39-9011) and "Special Education Teachers" (25-2050)

CCA Ex. 26. In his April 29, 2016 affidavit, Patrick Curtis (the Rubino accountant) stated that "Preschool Teachers" was a "more appropriate" occupational category for wage comparison purposes. 4/29/16 Curtis Aff., ¶ 6. CCA did not rebut that statement or give some reason for its apparent assumption that a freestanding Child Care program would employ *only* "childcare workers" and no "preschool teachers." *See* Att. H, ¶¶ 16-17; Att. K, ¶ 16.

pursuing its own self-interest. CCA did not negotiate or transact with a separate entity to "share personnel costs" or provide child care services. CCA alone incurred personnel costs whose benefits were shared by multiple programs. The cost principles required CCA to allocate those costs in proportion to the benefits they conferred on each of its programs.

In an attempt to clarify CCA's position, J. Michael Maddox, the CRI accountant, states that "[t]he combination of classrooms resulting from the partnering of the Head Start/Early Head Start and Child Care Services programs created significant savings to the Head Start/Early Head Start program and would not have been feasible based on Rubino's proposed cost allocation model that calls for equal allocation." Att. K, ¶ 15. Maddox further asserts that, in order to be equitable to both of its programs, the allocation of salary costs needs to account for "significant factors that [CCA] management would consider when assessing the decision to" combine its various child care programs. *Id.*, ¶ 12. "Clearly," says Maddox, "a prudent person acting under circumstances prevailing at the time the decision was made to incur costs, would not elect to combine these two programs [Head Start and Child Care] if the allocation of the most significant cost [salaries and wages] would result in an allocation to the non-federal program that would cause the costs of the program to exceed the revenues available through weekly rates charged to non-federal participants." *Id.*

This argument is unpersuasive. While each of CCA's programs must bear its fair share of joint costs, the applicable criterion for judging fairness in the context of the federal cost principles is relative benefits received, not whether expectations about the programs' financial performance have been met. In these circumstances, the cost principles neither require nor permit us to adjust Rubino's work to account for "significant factors" – factors which Maddox does not name – that might have informed CCA's decision to blend its Head Start and Child Care programs. In deciding whether to combine its programs, it was CCA's responsibility to become familiar with the federal government's longstanding cost principles and to assess their potential fiscal impact. The cost principles do not exist to guarantee the viability of a grantee's non-federal programs or to shield the grantee from unexpected consequences of program audits (such as a reallocation that "cause[s] the costs of [a non-federal] program to exceed the revenues available"). The cost principles exist to ensure that the federal government pays no more than its fair share of joint costs (as measured by relative benefits received) and, more generally, to ensure that federal funds are spent only for purposes authorized by the grantee's federal award. *Cf. Rio Bravo Assoc.*, DAB No. 1161, at 9 (1990) (stating that the "concept underlying the principle of allocability is that federal funds may be spent only for the purposes for which they were appropriated").

3. Disparities in teacher-to-student ratios

CCA next contends that Rubino overstated the Child Care program's allocable share of teacher and teaching assistant salaries because it did not consider the "differing student to teacher ratio requirements for Head Start versus those required by the State of Texas." CCA Ex. 1, at 5, 7-8.

Head Start program regulations require a grantee that operates a center-based Head Start program to "employ two paid staff persons (a teacher and a teacher aide or two teachers) for each class." 45 C.F.R. § 1306.20(c). Those regulations also limit class size: for example, "[f]or classes serving predominately four or five-year old children, the average class size of that group of classes must be between 17 and 20 children, with no more than 20 children enrolled in any one class"; and "[f]or classes serving predominately three-year old children, the average class size of that group of classes must be between 15 and 17 children, with no more than 17 children enrolled in any one class." *Id.* § 1306.32(a)(3), (5).

Texas law establishes "classroom ratios" for child-care centers that are licensed to care for 13 or more children. 40 Tex. Admin. Code §§ 746.1501, 746.1601. The classroom ratio – simply the maximum number of children any one "caregiver" may "supervise" – varies depending on the age of the children being supervised. *Id.* For example, a single caregiver may supervise up to 15 three-year old children or up to 18 four-year olds. *Id.*

CCA contends that teacher salary costs allocated to the Child Care program should be reduced by $1.247 million in order to reflect that Head Start teacher-to-student ratios are greater than the teacher-to-student ratios required by Texas law for the Child Care program.[15] CCA Ex. 1, at 7. In other words, CCA contends that its Child Care program should not be required to absorb salary costs incurred to ensure compliance with Head Start's higher minimum teacher-to-student ratios. In support of that proposition, CCA cites (again) the cost principles for determining "reasonable" costs, stating that "a prudent person negotiating an arms-length transaction for shared child care facilities and costs and exercising sound business practices would not be expected to share personnel costs at a student to teacher ratio exceeding that which would be statutorily required for the services performed." *Id.*

[15] CCA calculated its proposed adjustment based on a "staffing ratio analysis" which found that its Child Care program would have required less than one-half the "labor force" of the Head Start program had it operated separately in accordance with the minimum "classroom ratio" requirements of Texas law. *See* CCA Ex. 1, at 19. Although it far from clear that federal and state law would necessarily mandate different levels of staffing in all circumstances, we assume for purposes of our decision – as CCA evidently did – that federal law imposes somewhat more onerous requirements in all circumstances.

This proposed adjustment is similar to the one discussed in the previous section. Like the wage-differential adjustment, the teacher-to-student ratio adjustment would discount the Child Care program's allocable share of teacher salary costs (as calculated by Rubino) in order to recognize a disparity between minimum Head Start staffing requirements and Texas's presumably less-demanding requirements for child-care centers. Like the wage-differential adjustment, however, the teacher-to-student ratio adjustment does not call into question the appropriateness of the bases upon which Rubino allocated CCA's salary costs. Nor does that adjustment reflect or relate to any other estimate of the benefits conferred by those costs on CCA's programs. Consequently, we reject this proposed adjustment for reasons we stated in rejecting the wage-differential adjustment.

CCA implies that its proposed adjustments amount to a "standalone joint cost allocation" methodology. *See, e.g.*, CCA Ex. 1, at 8 (asserting that its teacher-to-student ratio adjustment ensures that Child Care's allocable share of teacher salaries "approximate[s] that which it would incur in a stand-alone environment, thus ensuring no undue benefit to the non-federal program"); Att. K, ¶ 39 (discussing the "Standalone Joint Cost Allocation Method"). However, CCA makes no attempt to show that the adjustments constitute proper applications of that methodology.[16] In his supplemental affidavit, J. Michael Maddox (the CRI accountant) suggests that Rubino's failure to allocate based on standalone cost is a "pitfall" in its methodology. Att. K, ¶ 39. Quoting section 958-720-55-30 of the *Accounting Standards Codification*, which describes the standalone allocation method, Maddox asserts that Rubino's failure to use that method "'result[s] in an *unreasonable allocation* because it ignores the effect of each function, which is performed jointly with other functions, on other such functions.'" Att. K, ¶ 39 (italics added). Maddox has misread ASC § 958-720-55-30. According to that provision, it is the inappropriate *use of a standalone method* – not the failure to use that method – that may produce the "unreasonable allocation" that Maddox describes. CCA Ex. 31.

4. Fringe benefits and indirect costs

CCA next contends that if the Child Care program's share of salary costs (as determined by Rubino) must be reallocated to Head Start in order to account for disparities in federal and state child care staffing requirements, then a "proportionate amount of fringe benefit costs" – which CCA determined to be $671,701 – must also be reallocated from Child Care to Head Start. CCA Ex. 1, at 9. We have just rejected the proposals to reduce Child Care's allocable share of salary costs. Consequently, there is no basis upon which to adjust Rubino's calculation of that program's allocable share of fringe benefit costs.

[16] In this context, the standalone method would appear to call for joint costs to be distributed on the basis of a ratio that is derived from estimates of *each program's* stand-alone costs of performing some common activity. *See infra note* 11. The adjustments that CCA proposes do not purport to allocate costs based on such a ratio, however.

Next, CCA requests that we reduce (by $241,888) Child Care's allocation of indirect costs. CCA Ex. 1, at 10. This request assumes that we agree to its proposed adjustments to Child Care's allocable share of salaries and fringe benefits. (As noted, each program's share of indirect costs was determined by applying CCA's negotiated indirect cost rate to the program's allocable share of salaries and fringe benefits.) Because we reject the proposed adjustments to Rubino's allocation of salary and fringe benefit costs, there is no basis to modify Child Care's allocable share of indirect costs.

5. Education and food supplies

Next, CCA contends that Rubino over-allocated costs of certain "education and food supplies" to the Wrap program. CCA Ex. 1, at 10. CCA's affiants stated that these supplies were used "almost exclusively" during "instructional periods" (that is, during Head Start and Child Care program hours) and for that reason were not properly allocable to the Wrap program, which operated before and after Head Start and Child Care instructional periods. *See* CCA Ex. 1, at 10; Att. D, ¶ 12; Att. I, ¶ 14; Att. K, ¶ 23. CCA calculated that Rubino misallocated $60,336 in education and food supply costs to the Wrap program. CCA Ex. 1, at 10.

In response, ACF noted that Rubino's reallocation methodology "assumed that children in the Wrap program benefitted from Education and Food Supplies on an equivalent basis to those children served by the Head Start Program and the Child Care Program." 4/29/16 Curtis Aff., ¶ 24. However, ACF stated that it could not, without additional investigation, dispute CCA's evidence that the Wrap program did not benefit significantly from education and food supplies. *Id.* Consequently, ACF conceded that the "offset proposed by [CCA] appears reasonable." *Id.*, ¶ 25. Given that concession, we reduce the remaining disallowance by $60,336.

6. Adult program meals

CCA contends that Rubino erroneously allocated the costs of "adult program meals" to the Child Care program. CCA Ex. 1, at 10-11. CCA furnished evidence that these meals were provided to teachers who staffed Head Start classrooms that CCA operated in partnership with ISDs, and that the meals were provided "as a result of a Head Start initiative requiring teachers to eat with the students." Att. D, ¶ 13. The costs were initially paid by the ISDs, which then obtained reimbursement from CCA. CCA Ex.18.

In response to this evidence, ACF admitted that the meal costs "result[ed] from the Head Start mandate that adults eat their meals with the children" but contended that the costs were properly allocated among CCA's programs "on an equal basis" because "[b]oth Head Start and non-Head Start children shared ISD centers and benefitted from the meals provided in these classrooms." 4/29/16 Curtis Aff., ¶ 27.

ACF's response is less than convincing. The issue raised by CCA is whether costs incurred for meals provided in *ISD partnership classrooms* should be charged in part to its Child Care program. So far as we can determine from the record before us, CCA did not provide Child Care services in ISD partnership classrooms. Furthermore, CCA offered unrebutted evidence that all students in those classrooms were enrolled in Head Start. Att. H. ¶ 11. While those students were also "dually enrolled" in state-funded "ISD pre-K," *id.*, Rubino's audit findings do not reflect any attempt to allocate costs between Head Start and the ISD-sponsored programs. For these reasons, we hold that $2,588 in adult program meal costs were improperly allocated to the Child Care programs and reduce the remaining disallowance by that figure.

7. <u>Other objections to the reallocation</u>

CCA contends that Rubino improperly relied upon certain accounting records to perform its reallocation. In order to identify and classify CCA's joint costs, Rubino examined "project ledgers" maintained by CCA for each child development center. 9/2/15 Curtis Aff., ¶ 10. In an affidavit, CCA's former controller, Teresa Williamson, stated that she personally compiled the project ledgers "directly from general ledger data[.]" Att. D, ¶ 10. She further stated:

> The project ledgers were created for internal purposes and were not intended or designed for use in audits or financial reviews. These ledgers were not used to accumulate costs for financial reporting, but rather to evaluate the rates used to generate the "child care reclass" journal entries. I am of the opinion that internal controls surrounding the proper classification of personnel by center were not adequate to place reliance on these ledgers for financial reporting purposes, as these ledgers were not created for such purposes. For instance, center employees were originally coded to their center of assignment upon hiring, however, due to the nature of these ledgers insufficient controls existed to ensure that staff re-assigned to centers after initial hiring were properly updated within the payroll system.

Id. Based on these statements, CCA contends that Rubino's reliance on the project ledgers is "improper and constitutes a material flaw in Rubino's audit findings and the resulting disallowance." CCA Response to Order at 3 (citation omitted).

We reject this contention for two reasons. First, we see insufficient evidence of any impropriety by Rubino. CCA evidently made the project ledgers available to Rubino, yet it proffered no evidence that it advised Rubino of their alleged unreliability during the

audit.[17] *See* CCA Response to Order at 7-10. Nor did CCA show that, prior to issuing its final audit findings, Rubino had reason to conclude from its examination of CCA's accounting practices and records that the project ledgers were, as CCA now says, a materially inaccurate source of cost data and that additional investigation was necessary to verify their reliability and usefulness. CCA has not alleged, or demonstrated, that Rubino violated any generally accepted auditing standard relating to the sufficiency of Rubino's audit evidence.[18]

Second, CCA has identified no *actual material* inaccuracies in the project ledgers, even though it presumably has access to accounting records (including its general ledger, the source of the project ledgers' data, according to Ms. Williamson) that would enable it to identify errors. CCA merely alleges an unquantified *risk* of errors due to insufficient "internal controls" whose nature CCA has failed to specify. Att. D, ¶ 11. Williamson vaguely described one type of potential error in the project ledgers (relating to proper "coding" of employees' place of work), *id.*, but did not explain how that error might have affected Rubino's calculations of each program's allocable share of joint costs. If, as CCA claims, the project ledgers were inaccurate, then CCA needed to have other cost accounting records that *were* accurate and complete in order to comply with federal requirements. *Cf.* 45 C.F.R. § 74.21(a) (Oct. 1, 2010) (requiring that grantees have "financial management systems that provide for "[a]ccurate, current and complete disclosure of the financial results of each HHS-sponsored project or program"). CCA does not tell us what other accounting records Rubino should have examined to verify the accuracy and completeness of cost data found in the project ledgers. Nor does CCA state that it offered such records to Rubino.

Finally, in a supplemental brief submitted on September 6, 2016, to which it attached five exhibits, CCA contends that its proposed adjustments to the reallocation are "fully supported by the layered funding adopted and sanctioned by ACF" in its Early Head Start-Child Care Partnerships (EHS-CCP) grant program. 9/6/16 Supp. Br. at 4. Under that program, launched in 2014, ACF issues grants to entities (which may include existing Early Head Start grantees) who agree to enter partnerships with local child care centers or family child care programs that serve infants and toddlers from low-income families. *Id.*, Exhibit 5. A goal of the program is to expand the capacity of the grantee's child care partner to provide high-quality, comprehensive child care services. *Id.*, Exhibits 4-5. The program uses a "layered" funding model that leverages child care

---

[17] The Board's Order to Develop the Record expressly invited CCA to proffer evidence on this issue.

[18] Under Generally Accepted Government Auditing Standards, "[a]uditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions." Government Accountability Office, Comptroller General of the United States, *Government Auditing Standards* (2011 Revision), Chapter 6, ¶ 6.56 (available at http://www.gao.gov/assets/590/587281.pdf (last visited Sept. 27, 2016)).

subsidies, grant funding, and other financial resources to achieve its objectives. *Id.,* Exhibit 5, at 4-5. "Layer 2" funding, provided by the EHS-CCP grant, helps to pay for enhancements to the services provided by the grantee's child care partner. *Id.*, Exhibit 5, at 5. Those enhancements may include, for example, increased pay for teachers who meet EHS education requirements, hiring additional staff to meet EHS-mandated staff-to-child ratios, and other changes to bring the partner's services up to EHS standards. *Id.*, Exhibit 5, at 5. If the enhancements benefit the child care partner's EHS clients, then their costs may be financed entirely with EHS-CCP grant funds, even if the costs benefit other children who receive services in the same setting. *Id.*, Exhibit 2.

CCA suggests that it used its own Head Start grant funds to enhance the quality and comprehensiveness of services delivered to its Child Care clients, much as a EHS-CCP grantee would use that program's "Layer 2" funds to enhance the services of its child care partner. 9/6/16 Supp. Br. at 2. CCA submits that because its blending of Head Start and Child Care programs operated on a "funding model" similar to the one authorized by the EHS-CCP, it should be able to allocate to its Head Start awards the costs that enabled it to deliver Head Start-quality services to its Child Care clients, *irrespective of relative benefits received*. CCA asserts that its proposed adjustments relating to Head Start-Child Care staffing requirements effectuate such an allocation. *See id.* at 2-3 (complaining that Rubino's methodology "does not allow for enhancements that benefit all children enrolled in Head Start and child care to be paid for by federal head start funds" but instead calls for costs to be "shared equally by Head Start and Child Care based on the benefit received").

This argument – which essentially confirms that the proposed adjustments relating to program staffing requirements were not designed or intended to ensure an allocation based on relative benefits received – is untenable. While CCA may have pursued desirable goals in blending its Head Start and Child Care programs, it was nonetheless required to allocate costs in accordance with the terms and conditions of its Head Start awards, which were not issued under the EHS-CCP program. A Head Start award's terms and conditions include applicable federal cost principles. *See* 45 C.F.R. § 1301.10(a); *William Smith, Sr. Tri-County Child Development Council, Inc.*, DAB No. 2647, at 1-2 (2015); *Council for the Spanish Speaking, Inc.*, DAB No. 2718, at 2-3 (2016). Absent a contrary statute or regulation, those principles require that costs be allocated in accordance with relative benefits received. 45 C.F.R. § 75.405(a); 2 C.F.R. Part 230, ¶ A.4.a. (Jan. 1, 2013). CCA has not demonstrated that its Head Start awards authorized any departure from that principle.

Conclusion

Upon clarifying its position at the initial stage of this appeal, ACF maintained that CCA had improperly allocated $2,342,125 in costs to its Head Start awards (06CH021/36 and 06CH0021/37) for the period November 1, 2010 through October 31, 2012. We hold that that $62,924 of those costs ($60,336 for education and food supplies plus $2,588 for adult program meals) were properly allocated to Head Start. We hold that the remaining disallowed costs were allocated to Head Start in violation of federal cost principles. We therefore conclude that ACF properly disallowed $2,279,201 – or $2,342,125 minus $62,924 – in Head Start funding for the period November 1, 2010 through October 31, 2012.

/s/

Leslie A. Sussan

/s/

Constance B. Tobias

/s/

Sheila Ann Hegy
Presiding Board Member