Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

SOUTHWEST KEY PROGRAMS FAILED TO PROTECT FEDERAL FUNDS INTENDED FOR THE CARE AND PLACEMENT OF UNACCOMPANIED ALIEN CHILDREN

Inquiries about this report may be addressed to the Office of Public Affairs at Public.Affairs@oig.hhs.gov.

Christi A. Grimm
Principal
Deputy Inspector General

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A-06-17-07004

Office of Inspector General

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OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

Report in Brief
Date: September 2020
Report No. A-06-17-07004

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES
OFFICE OF INSPECTOR GENERAL

Why OIG Did This Audit

The Office of Refugee Resettlement (ORR) within the Department of Health and Human Services, Administration for Children and Families (ACF), manages the Unaccompanied Alien Children (UAC) Program. We initiated a series of audits of UAC Program grantees because, beginning in fiscal year (FY) 2012, there were significant increases in both the number of children served by the UAC Program and program funding, as well as multiple changes to ORR policies beginning in FY 2014.

We selected Southwest Key Programs (Southwest Key), a UAC Program grantee, to audit because it is one of the largest providers of services to children in the UAC Program. We conducted this audit in conjunction with our review of Southwest Key's safety standards for the care and release of children in its custody.

Our objective was to determine whether Southwest Key claimed only allowable expenditures in accordance with applicable laws and regulations during Federal FY 2016.

How OIG Did This Audit

We reviewed a statistical sample of financial transactions in FY 2016 and Southwest Key's financial management system.

Southwest Key Programs Failed To Protect Federal Funds Intended for the Care and Placement of Unaccompanied Alien Children

What OIG Found

Southwest Key claimed unallowable costs related to the UAC Program. Based on our financial review results, we determined that Southwest Key claimed unallowable costs for capital leases, a related-party lease, and other ancillary costs related to leases. Southwest Key also claimed unallowable compensation related to influx bonuses and executive compensation. Additionally, Southwest Key claimed other unallowable expenses. We also determined that Southwest Key's financial management system lacked effective controls for ensuring accountability of Federal funds. Specifically, Southwest Key did not comply with Federal regulations and ensure that it followed its own policies and procedures.

What OIG Recommends

We recommend that Southwest Key: (1) refund to the Federal Government $10,529,446 in unallowable direct costs and $1,246,973 in associated indirect costs; (2) refund to the Federal Government $1,354,429 in unallowable executive compensation; (3) implement procedures to review leases and ensure that all rental and ancillary costs claimed comply with Federal regulations; (4) ensure that no Federal funding, direct or indirect, is used for future compensation that exceeds the statutorily allowed rate for executive compensation; and (5) maintain documentation supporting Federal financial reports. We also made policy and procedural recommendations.

Additionally, we recommend that ORR: (1) review remaining Southwest Key leases to ensure that the leases are in compliance with Federal regulations and recover any unallowable costs, (2) provide guidance on allowable costs, and (3) review Southwest Key's bonus policy to ensure compliance with Federal regulations. We also made a procedural recommendation.

In written comments on our draft report, Southwest Key disagreed or partially disagreed with all but one of our findings and outlined actions it has taken and plans it has to address the findings. We maintain that our findings and recommendations are valid. In written comments on our draft report, ACF generally concurred with five of our six recommendations and indicated that it will consider OIG's work regarding lease and bonus findings.

Southwest Key's and ACF's comments are summarized in the report and included in the appendices.

The full report can be found at https://oig.hhs.gov/oas/reports/region6/61707004.asp.

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INTRODUCTION

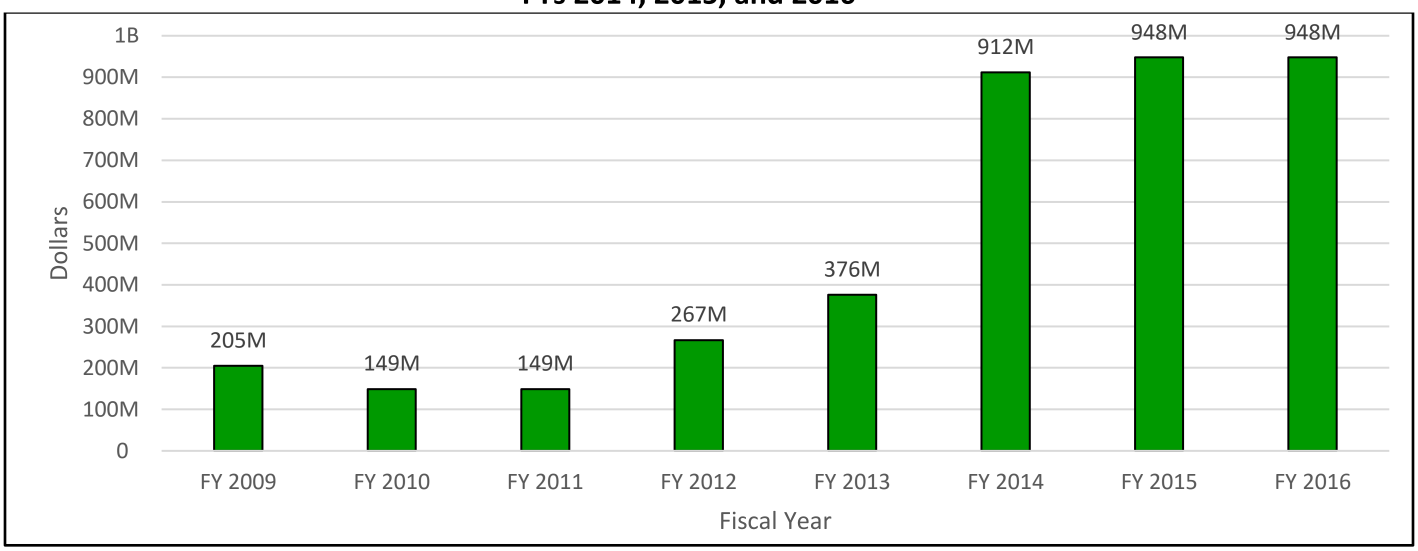
WHY WE DID THIS AUDIT

The Office of Refugee Resettlement (ORR) within the Department of Health and Human Services (HHS), Administration for Children and Families (ACF), manages the Unaccompanied Alien Children (UAC) Program. Because of the increase in the number of vulnerable children who entered ORR care, significant increases in program funding, and multiple changes to ORR policies during Federal fiscal year (FY) 2014, we have been conducting a series of audits of ORR care providers across the Nation.[1]

The UAC Program served between 7,000 and 8,000 children annually from FYs 2005 through 2011. In FY 2012, however, the number of children entering the program began to increase, and by the end of FY 2012, the program served 13,625 children. In FY 2013, the program served 24,668 children; in FY 2014, it served 57,496 children; and in FY 2015, it served 33,726 children. In FY 2016, the UAC Program served 59,170 children.

From FY 2009 through FY 2016, ORR's funding for its UAC Program totaled more than $3.9 billion, of which $2.8 billion (71 percent) was for FYs 2014, 2015, and 2016. (See Figure 1.)

Figure 1: Unaccompanied Alien Children Program Funding Was Substantially Higher in FYs 2014, 2015, and 2016



We selected Southwest Key Programs (Southwest Key) to audit because it is one of the largest providers of services to children in the UAC Program. We conducted this audit of Southwest Key's financial management of Federal funds received during FY 2016 in conjunction with our

[1] See Appendix B for a list of previously issued reports.

review of Southwest Key's compliance with health and safety requirements for the UAC Program and a review of Southwest Key's information system general controls.[2]

OBJECTIVE

The objective of this review was to determine whether Southwest Key claimed only allowable expenditures in accordance with applicable laws and regulations during FY 2016.

BACKGROUND

The Unaccompanied Alien Children Program

The UAC Program funds temporary shelter care[3] and other related services for children in ORR custody. For project periods[4] with services beginning during FYs 2014 and 2015, ORR awarded grants totaling $2.1 billion to providers for the care and placement of children. The UAC Program is separate from State-run child welfare and traditional foster care systems.

Applicable Federal Requirements

Federal regulations establish uniform administrative requirements for awards to nonprofit organizations. For grant awards made on or after December 26, 2014, 45 CFR part 75 establishes uniform administrative requirements, cost principles, and audit requirements for Federal awards to non-Federal entities. Southwest Key had three cooperative agreements—90ZU0148, 90ZU0149, and 90ZU0153—that were in effect from October 1, 2014, through September 30, 2017. However, our audit period included awards made after December 26, 2014, to which Part 75 applied.

Southwest Key Programs

Southwest Key is a nonprofit organization based in Austin, Texas. For nearly 20 years, Southwest Key has participated in the UAC Program. In FY 2016, Southwest Key was awarded approximately $236 million in grants for residential services for children in the UAC Program and claimed approximately $231 million in Federal funds to care for children in its custody, which included approximately 25,000 children who were released directly to parents, family

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[2] *Southwest Key Programs Did Not Always Comply With Health and Safety Requirements for the Unaccompanied Alien Children Program* (A-06-17-07005) and *Southwest Key Did Not Have Adequate Controls in Place To Secure Personally Identifiable Information Under the Unaccompanied Alien Children Program* (A-18-18-06001), issued August 15, 2019.

[3] Shelter care is provided in a residential care provider facility where all the program components are administered onsite in the least restrictive environment.

[4] A project period for the UAC Program is 36 months with three 12-month budget periods.

members, or other adults who are able to provide for their care; aged out of the program; ran away; or transferred to another facility. During FY 2016 Southwest Key operated a total of 26 residential shelter programs in Arizona (8), California (3), and Texas (15).

HOW WE CONDUCTED THIS AUDIT

Our audit covered $184,845,038 in general ledger transactions for residential services for FY 2016, which was from October 1, 2015, through September 30, 2016 (audit period).

To determine whether Southwest Key claimed only allowable expenditures for its grants for residential services, we reviewed a stratified random sample of 1,200 financial transactions[5] totaling $25,179,084 that were recorded in Southwest Key's general ledger. We also reviewed Southwest Key's financial management system.

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

Appendix A contains the details of our audit scope and methodology; Appendix C contains the Federal, accounting, and Southwest Key requirements; Appendix D contains our statistical sampling methodology; and Appendix E contains the sample results and estimates.

FINDINGS

Based on our sample results, we estimated that Southwest Key claimed unallowable direct costs totaling at least $10,879,121. These costs were not properly accounted for or supported. Southwest Key claimed unallowable indirect costs totaling $1,246,973[6] associated with unallowable lease payments and compensation. In addition, Southwest Key paid $1,354,429 in unallowable executive compensation that exceeded the statutorily allowed rate.

Specifically, we determined that Southwest Key:

- claimed unallowable costs for leases,
- claimed unallowable compensation,

[5] The stratified sample included seven strata; under three of these strata, we reviewed all general ledger transactions. These strata related to yearend bonuses (358 transactions), building or property leases (613 transactions), and salary accruals (49 transactions).

[6] The unallowable indirect costs are associated with the strata where all general ledger transactions were reviewed.

- claimed other unallowable costs, and

- lacked effective control over and accountability of Federal funds.

These deficiencies occurred because Southwest Key did not comply with Federal regulations or ensure that it followed its own policies and procedures.

SOUTHWEST KEY CLAIMED UNALLOWABLE COSTS FOR LEASES

For 135[7] of the 613[8] financial transactions we reviewed related to building or property leases, Southwest Key claimed $6,746,090 in unallowable direct costs, and $827,197[9] associated indirect costs, for capital leases, a related-party lease, and ancillary costs associated with leases. Southwest Key did not comply with Federal regulations that limit the allowable costs for capital and related-party leases. Additionally, Southwest Key claimed costs for common area maintenance and additional rent that were unsupported.

Southwest Key Claimed Unallowable Costs for Capital Leases

Federal regulations state that rental costs for leases that are required to be treated as capital leases under Generally Accepted Accounting Principles (GAAP) are allowable only up to the amount that would be allowed if the non-Federal entity had purchased the property on the date the lease agreement was executed (45 CFR § 75.465(c)(5)).[10] This amount would include expenses such as depreciation, maintenance, taxes, and insurance (45 CFR § 75.465(b)). Depreciation must be based on the acquisition cost of the assets involved and must exclude the cost of land (45 CFR § 75.436(c)(1)).

For 67 of the 135 unallowable lease transactions, Southwest Key claimed $3,168,216 and $456,223 in associated indirect costs for unallowable lease expenses for 6 of the 10 facility

[7] Some transactions had more than one error.

[8] The stratified sample included seven strata. For this stratum related to buildings or property leases, we reviewed all general ledger transactions.

[9] The unallowable indirect costs are associated with the stratum where all general ledger transactions were reviewed.

[10] According to GAAP, leases are required to be recorded as a capital lease if they meet one of four criteria (Accounting Standards Update 2016-02). Under one of these criteria, if the present value of the minimum lease payments is at least 90 percent of the fair value of the asset at the inception of the lease, the lease should be recorded as a capital lease.

leases for which we were able to obtain appraisal information. Southwest Key did not properly account for six leases that met the present value[11] criteria of a capital lease under GAAP. Southwest Key claimed the full lease amount for the facilities to the UAC Program rather than limiting the lease costs to the amount that would be allowable if it had purchased the property when the lease was executed. Southwest Key officials stated that they were not evaluating facility leases to determine whether they met any of the criteria to be accounted as a capital lease under GAAP.

Table 1: Southwest Key Unallowable Capital Lease Expenses

Facility	Amount Claimed as Operating Lease	Depreciation*	Maintenance, Taxes, and Insurance	Amount Claimable as Capital Lease	Unallowable Lease Expenses
A	$660,000	$24,923	0	$24,923	$635,077
B	125,238	9,248	0	9,248	115,990†
C	480,000	7,692	0	7,692	472,308
D	600,000	14,103	0	14,103	585,897
E	845,000	61,889	0	61,889	783,111
F	617,500	41,667	0	41,667	575,833
Total	**$3,327,738**	**$159,522**	**0**	**$159,522**	**$3,168,216**

* Depreciation was calculated on the total acquisition price of the property; the cost of land was not available.

† ACF identified this lease, a less-than-arm's-length lease, as part of its review of leases and contracts executed by Southwest Key during the period January 1, 2006, through March 31, 2019. In July 2019, ACF issued a disallowance letter based on its review, and because this lease was included in ACF's disallowance, we will not recommend recovery of the unallowable rental costs or the associated indirect costs of $16,703.

Southwest Key Claimed Unallowable Rental Costs for a Related-Party Lease

Rental costs under less-than-arm's-length leases are treated as if the grantee owned the property. Only those costs that the grantee would have incurred if it had owned the property are allowable (45 CFR § 75.465(c)). This amount would include expenses such as depreciation, maintenance, taxes, and insurance (45 CFR § 75.465(b)). Depreciation must be based on the acquisition cost of the assets involved and must exclude the cost of land (45 CFR § 75.436(c)(1)).

For 25 of the 135 unallowable lease transactions, Southwest Key claimed $233,684 and $33,650 in associated indirect costs for unallowable rental costs related to a less-than-arm's-length

[11] The present value of the minimum lease payments at the beginning of the lease term equals or exceeds 90 percent of the excess of the fair value of the leased property at the inception of the lease.

lease for 1 facility.[12] Southwest Key leased the facility from a limited partnership that included the president and chief financial officer of Southwest Key as partners. Because Southwest Key officials have the ability to control or substantially influence the actions of Southwest Key, the lease between the limited partnership and Southwest Key is less than arm's length and subject to limitations on rental costs. Southwest Key officials did not consider the limited partnership a less-than-arm's-length lease because they did not consider themselves active participants in managing the partnership.

Southwest Key Claimed Unallowable Ancillary Costs Associated With Leases

To be allowable under an award, costs must be necessary and reasonable for the performance of the Federal award, be allocable under the cost principles, and be adequately documented (45 CFR § 75.403). Costs are allocable to a particular cost objective, such as a grant, in accordance with relative benefits received (45 CFR § 75.405(a)). Further, 45 CFR § 75.400(d) states that the non-Federal entity's accounting practices must provide adequate documentation to support costs charged to a Federal award.

Southwest Key Claimed Unallowable Common Area Maintenance Fees

For 34 of the 135 unallowable lease transactions, Southwest Key claimed $2,342,522 in common area maintenance (CAM) fees and $337,323 in associated indirect CAM fees that were not supported by documentation adequate to show that the fees benefited the UAC Program. Southwest Key entered into leases that included CAM fees, which according to the leases include "all costs and expenses of every type and nature, foreseen and unforeseen, incurred or expended by Landlord in the operation, management, and maintenance of the Premises." The leases also included, to the extent possible, all tax-related charges, fees, and assessments. Southwest Key was unable to provide documentation to support the CAM fees. As a result, there is no assurance that the costs were necessary and reasonable. Additionally, Southwest Key officials stated that they did not review any supporting documentation from the landlord to ensure that these costs were allocable to the UAC Program.

Southwest Key Claimed Unallowable Costs for Additional Rent

For 15 of the 135 unallowable lease transactions, Southwest Key claimed $1,001,667[13] for unallowable "additional rent" during our audit period. Southwest Key entered into three lease agreements that required a payment for additional rent due upon commencement of the lease.

[12] This lease was also identified as a less-than-arm's-length lease by ACF as part of its review of leases and contracts executed by Southwest Key from January 1, 2006, through March 31, 2019. In July 2019, ACF issued a disallowance letter based on its review, and because this lease was included in ACF's disallowance, we will not recommend recovery of the unallowable rental costs or the associated indirect costs of $33,650.

[13] Southwest Key's indirect cost base excludes alterations and renovations, so associated indirect costs will not be recovered for the additional rent.

The lease agreements did not specify the purpose or use of the additional rent paid. According to a Southwest Key official, the upfront costs in the leases were for renovating the facilities.

A Southwest Key official told us that UAC facilities present a unique need and therefore Southwest Key must pay for renovations to the facilities. Furthermore, Southwest Key officials stated that if the landlord were renting the facility to another entity, there would be no need for these renovations. Southwest Key was unable to provide supporting documentation to show this payment was allocable to the UAC Program.

SOUTHWEST KEY CLAIMED UNALLOWABLE COMPENSATION

For 281 of the 358[14] financial transactions we reviewed related to yearend bonuses, Southwest Key claimed $3,264,782 in unallowable influx bonuses and $470,129[15] of associated indirect costs. Southwest Key was unable to provide supporting documentation to show that employees were involved in expanding bed capacity and qualified for an influx bonus. In addition, Southwest Key paid $1,354,429 in unallowable executive compensation that exceeded the Executive Level II salary limit for six employees. Finally, Southwest Key's bonus policy allowed for bonuses to be paid at an unspecified percentage of base salary, which could lead to unreasonable bonuses paid with Federal funds.

Southwest Key Claimed Unallowable Influx Bonuses

Federal regulations state:

> Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., is allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the non-Federal entity and the employees before the services were rendered, or pursuant to an established plan followed by the non-Federal entity so consistently as to imply, in effect, an agreement to make such payment [45 CFR § 75.430(f)].

Southwest Key's bonus structure in effect during the audit period was applicable to all management and non-management employees in the UAC Program. Bonuses were awarded based on the categories listed in Southwest Key's "Operations Manual for Unaccompanied Minor Programs" and as funds permit in that FY's budget. During an influx,[16] employees could

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[14] The stratified sample included seven strata; for this stratum related to yearend bonuses, we reviewed all general ledger transactions.

[15] The unallowable indirect costs are associated with the stratum where all general ledger transactions were reviewed.

[16] A state of influx occurs when ORR has 5 percent or less of its total shelter bed capacity available. *ORR Guide: Children Entering the United States Unaccompanied* (Published January 30, 2015).

earn a certain percentage of their base salary as a bonus for efforts to expand bed capacity (influx bonus). For example, an employee could earn an influx bonus for working extra hours covering for employees assisting with starting up a new program, working at job fairs, or preparing existing or new programs for increased capacity. Southwest Key paid bonuses subject to the availability of funds, and the bonus percentage was based on an employee's individual effort (*Operations Manual for Unaccompanied Minor Programs*, revised March 2015).

For 281 of the 358 yearend bonus transactions, Southwest Key paid unallowable influx bonuses (20 percent of employee's base salary) and related fringe benefits totaling $3,264,782 and associated indirect costs of $470,129. Southwest Key provided a document that included a listing of employees who received bonuses and the bonus amounts. However, Southwest Key did not provide documentation, such as personnel action forms, supporting that these employees were involved in activities to expand bed capacity, thus qualifying for influx bonuses.

Southwest Key Paid Six Employees Excessive Executive Compensation

Federal awards may be subject to statutory requirements that limit the allowability of costs, including statutory ceilings on allowable compensation (45 CFR §§ 75.408 and 75.430(d)(2)). The appropriations acts in effect during the audit period[17] contained a rider stating: "[N]one of the funds appropriated in this title shall be used to pay the salary of an individual, through a grant or other extramural mechanism, at a rate in excess of Executive Level II." The Executive Level II pay rate effective January 10, 2016, was $185,100.[18] Additionally, the Funding Opportunity Announcement for the grant that ORR awarded to Southwest Key states, "Award funds issued under this announcement may not be used to pay the salary, or any percentage of salary, to an individual at a rate exceeding Executive Level II."[19]

Southwest Key paid six employees a rate exceeding the Executive Level II salary limit of $185,100 for FY 2016. The unallowable excess compensation totaled $1,354,429. Southwest Key officials stated that these salaries were primarily paid from the indirect funds it received from HHS. Southwest Key was unable to provide supporting documentation to show that any of the salary amounts exceeding the statutory ceiling were paid with non-Federal funds.

[17] Consolidated and Further Continuing Appropriations Act, 2015, P.L. No. 113-235 (enacted on Dec. 16, 2014, as extended through three continuing appropriation resolutions); Consolidated Appropriations Act. 2016, P.L. No. 114-113 (enacted on Dec. 18, 2015).

[18] The Executive Level II pay rate effective October 1, 2015, through January 9, 2016, was $183,300. We are using the higher amount because it was in effect during the majority of the audit period.

[19] *Residential Services for Unaccompanied Alien Children*, HHS-2015-ACF-ORR-ZU-0833.

Southwest Key's Bonus Policy Could Allow for Unreasonable Bonuses

Federal regulations state that to be allowable, a cost must be necessary and reasonable for the performance of the Federal award (45 CFR § 75.403). A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. This determination is fact specific and based on a number of factors, including whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the Federal Government and the public at large (45 CFR § 75.404(d)).

In reviewing the allowability of Southwest Key's bonus payments, we identified a vulnerability in its bonus policy in effect during the audit period. Southwest Key's bonus policy allowed for bonuses to be paid based on specific categories of performance and as funds permit. Southwest Key policy stated that some categories of bonuses could be paid at a "certain percentage" of the employees' base salaries. Without a limitation on the bonus percentage, bonuses paid with Federal funds could exceed the amount which would be incurred by a prudent person, considering their responsibilities to the Federal Government, and thus be unreasonable.

SOUTHWEST KEY CLAIMED OTHER UNALLOWABLE COSTS

Federal regulations state that costs must be "necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles" and be adequately documented (45 CFR § 75.403). In addition, Federal regulations state that the accounting practices of the non-Federal entity must provide for adequate documentation to support costs charged to the Federal award (45 CFR § 75.400(d)). Furthermore, Federal regulations require that "a cost is allocable to a particular Federal award or other cost objective if the goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received" (45 CFR § 75.405(a)).

For 11 of the 229 other sampled financial transactions we reviewed, Southwest Key claimed $139,843 in unallowable costs for salary and fringe benefits and other unallowable costs.

- **Salary and fringe benefits**. For 9 of the 11 unallowable financial transactions, Southwest Key did not provide earning and leave statements or other documentation supporting 5 transactions that involved employee payroll that Southwest Key charged to the grant. Also, for four transactions, Southwest Key paid employees using incorrect hours or rates of pay or made duplicate payments. The transactions resulted in unallowable direct costs totaling $129,835.

- **Other costs**. For 2 of the 11 unallowable direct costs, Southwest Key claimed unallowable direct costs for other expenditures not related to direct salary and fringe benefit costs. Specifically, Southwest Key: (1) claimed unallowable contract labor costs that occurred outside the award period and (2) did not provide support for personal care items. These transactions resulted in unallowable direct costs totaling $10,008.

SOUTHWEST KEY LACKED EFFECTIVE CONTROL AND ACCOUNTABILITY OF FEDERAL FUNDS

Southwest Key lacked effective control and accountability of Federal funds under the UAC Program. Southwest Key was unable to account for Federal funds, was unable to support the expenses and indirect cost base reported on its Federal financial reports (FFRs) and did not record fixed assets timely.

Southwest Key Did Not Adequately Safeguard Federal Funds

The financial management system of each non-Federal entity must provide records that adequately identify the source and application of funds (45 CFR § 75.302(b)(3)). Additionally, the non-Federal entity must safeguard all assets and assure that they are used solely for authorized purposes (45 CFR §75.302(b)(4)).

Southwest Key was unable to account for the Federal funds for the UAC Program once the funds left Southwest Key's Depository account (the account in which these funds are initially deposited). Federal funds for the UAC Program are swept daily into Southwest Key's master account, which includes both Federal and non-Federal funds for a variety of programs. Although it is not necessary for a grantee to maintain a separate account for Federal funds, the grantee must be able to document that these funds are used for allowable expenses under the award (45 CFR §75.305(b)(7)(i)). Southwest Key could not provide adequate documentation showing that Federal funds were being used solely and completely for the UAC Program. Southwest Key officials stated that they used journal entries to ensure that Federal funds were used for the UAC Program. However, the journal entry tracked only the expense, not the source of the funds.

Southwest Key Was Unable To Support Expenses and the Indirect Cost Base on Its Federal Financial Reports

Federal regulations require grantees to retain financial records, supporting documents, statistical records, and all other records pertinent to a Federal award for 3 years from the date of submission of the final expenditure report or, for awards that are renewed annually, from the date of the submission of the annual financial report, respectively, as reported to the HHS awarding agency or pass-through entity (45 CFR § 75.361).

Southwest Key did not maintain adequate documentation for expenses[20] and the indirect cost base[21] reported on its quarterly FFRs. Southwest Key officials were unable to locate the file containing the documentation to support the expenses reported on the FFR. Southwest Key officials stated that although the indirect cost base amounts were not reported correctly on the FFRs, they could get the correct base amount using their workpapers. However, Southwest Key was unable to provide us with workpapers that adequately supported the indirect cost base amounts. Without accurate FFRs, ORR cannot provide effective oversight of Southwest Key's program expenditures.

Southwest Key Did Not Record Fixed Assets Timely

Federal regulations require the financial management system of a non-Federal entity to provide accurate, current, and complete disclosure of the financial results of each Federal award (45 CFR § 75.302(b)(2)).

Southwest Key overstated its fixed assets by $107,478 during our audit period. The fixed asset schedule contained fixed assets transactions that occurred before and after our audit period. However, the fixed asset transactions were recorded as occurring during our audit period. According to Southwest Key officials, some of these transactions were entered late because Southwest Key was short-staffed. For transactions that occurred after our audit period, Southwest Key officials stated that those transactions should not have been included on the fixed asset schedule. Southwest Key's indirect costs are based on the total direct costs excluding costs related to fixed assets, which include buildings, individual items of equipment, and alterations and renovations. By not recording fixed assets timely, Southwest Key is not calculating indirect costs correctly on its FFR.

RECOMMENDATIONS

SOUTHWEST KEY RECOMMENDATIONS

We recommend that Southwest Key Programs:

<u>Unallowable Costs</u>

- refund to the Federal Government $10,529,446 in unallowable direct costs and $1,246,973 in associated indirect costs;

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[20] According to the *Federal Financial Report Instructions for Grant Recipients* (revised June 28, 2010), "[f]or reports prepared on an accrual basis, expenditures are the sum of cash disbursements for direct charges for property and services; the amount of indirect expense incurred; and the net increase or decrease in the amounts owed by the recipient . . . ."

[21] According to the Southwest Key *Nonprofit Rate Agreement*, dated June 17, 2014, the indirect cost base is the "[t]otal direct costs excluding capital expenditures (buildings, individual items of equipment, alterations and renovations), that portion of each subaward in excess of $25,000 and flow-through funds."

- refund to the Federal Government $1,354,429 in unallowable executive compensation;

Leases

- review UAC facility leases, and, for those that qualify as capital or related-party leases, ensure that rental costs claimed comply with Federal regulations;

- implement procedures to review leases and ensure that any ancillary costs claimed comply with Federal regulations;

Compensation

- maintain supporting documentation that shows employees who receive a bonus qualify for the bonus and that bonuses paid comply with Southwest Key's bonus policy and Federal regulations;

- revise the bonus policy to establish a maximum percentage when calculating bonuses paid with Federal funds and to ensure that all bonuses are reasonable;

- ensure that no Federal funding, direct or indirect, is used for future compensation that exceeds the statutorily allowed rate for executive compensation;

Other Unallowable Costs

- develop a quality control procedure to ensure that costs claimed are accurate, adequately supported, and benefit the award;

Effective Control and Accountability

- maintain documentation to support the FFRs; and

- strengthen policies and procedures and develop a quality control measure to ensure that the fixed assets are recorded timely and in the correct period.

OFFICE OF REFUGEE RESETTLEMENT RECOMMENDATIONS

We recommend that the Office of Refugee Resettlement:

- review Southwest Key's remaining UAC facility leases to determine whether they qualify as capital leases, and recover any unallowable costs;

- review the capital leases identified in our audit to determine the amount of unallowable costs associated with the leases since their inception and after our review, and recover any unallowable costs;

- review UAC facility leases since their inception and after our review to ensure the leases meet Federal requirements and include only allowable costs, and recover any unallowable costs;

- provide guidance to Southwest Key related to allowable renovation costs and when prior approval for renovations is required;

- ensure that Southwest Key adheres to the statutorily allowed rate for executive compensation; and

- review Southwest Key's bonus policy to ensure that it meets Federal requirements.

OTHER MATTERS

SOUTHWEST KEY'S INDIRECT COST RATE RESULTED IN INCREASED NET ASSETS

In FY 2016,[22] Southwest Key's direct costs increased substantially in response to ORR's request for it to expand its bed capacity to house more children during FY 2016. However, Southwest Key's indirect costs[23] did not increase at the same rate as its direct costs. Southwest Key's not-for-profit audited financial statements for FY 2016 showed an increase in net assets of $16.5 million. In reviewing Southwest Key's financial records, we determined that at least $11.5 million of the increase was composed of unspent UAC Program funds that Southwest Key received as indirect costs.

Southwest Key had a predetermined indirect cost rate[24] of 14.4 percent in effect from September 1, 2014, through August 31, 2018, which was negotiated and approved by HHS's Office of Cost Allocation Services (CAS). A predetermined rate, according to Federal regulations, "may be negotiated for use on federal awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs" (45 CFR part 75,

[22] Southwest Key's FY is September 1 through August 31.

[23] Indirect costs are costs incurred for a common or joint purpose that benefits more than one cost objective and is not readily assignable to the cost objectives specifically benefited. Direct costs associated with the UAC Program are linked to the number of children served who require additional direct services; indirect costs related to administration and support do not necessarily increase at the same rate.

[24] A predetermined indirect cost rate means an indirect cost rate, applicable to a specified current or future period, usually the organization's FY. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment (45 CFR Appendix IV to part 75, C.1.b).

App. IV, C.2.d.). Predetermined rates are not subject to adjustment based on actual incurred costs (45 CFR part 75, App. IV, C.1.b). Given the risk that a grantee may receive insufficient or surplus funds based on a predetermined indirect cost rate, this type of rate should be used only when facts and past experience allow for an informed judgment about the probable level of indirect costs incurred during the accounting periods. Considering the significant increase in direct costs associated with this program, HHS may want to reevaluate the use of predetermined indirect cost rates.

The amount of funds Southwest Key received for indirect costs was based on total allowable direct costs, excluding capital expenditures, which were laid out in its indirect cost rate proposal. As required by Federal regulations, Southwest Key certified that the proposal upon which the rate was to be based did not include any unallowable costs (45 CFR Part 75, App. IV, D.3.). Southwest Key drew Federal funds for indirect costs based on its direct costs of the program, using the approved indirect cost rate. Our audit did not review the allowability of costs in the indirect cost proposal. However, based on our findings, it is reasonable to believe that Southwest Key's proposal included unallowable costs as specified in Federal statutes, regulations, and the terms and conditions of the award. Additionally, we have communicated our concerns related to the use of a predetermined indirect cost rate and Southwest Key's indirect cost rate proposal to CAS.

SOUTHWEST KEY CLAIMED PROPERTY TAXES

Southwest Key claimed property taxes for some of its leased facilities that qualified as capital leases and for its related-party lease. Although taxes are an allowable cost related to a lease, property taxes might not be allowable if Southwest Key met the conditions to qualify for exemption from these taxes because of its not-for-profit status under Texas law.[25] If it qualified for an exemption, Southwest Key should not have claimed the property taxes associated with these leased facilities. We are not recommending recovery of any unallowable property taxes, as we did not assess whether Southwest Key qualified for an exemption as part of our review of the one transaction related to property taxes selected in our sample. However, costs associated with any unallowable property tax transactions would be recovered pursuant to our recommendation to recover estimated unallowable costs.

SOUTHWEST KEY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, Southwest Key disagreed or partially disagreed with all but one of our findings, provided what it believes is important context to some findings, and outlined actions it has taken and plans to take to address the findings. Southwest Key's comments are included as Appendix F. We redacted sensitive information from Southwest Key's comments.

[25] Texas Administrative Code, Title 34, Part 1, Ch. 9, § 9.417 (as amended, Apr. 3, 2012)

SOUTHWEST KEY CLAIMED UNALLOWABLE RENTAL COSTS FOR CAPITAL LEASES

Southwest Key Comments

Southwest Key disagreed with our finding on rental costs for capital leases. It stated that any lease tied to cancelable funding is appropriately characterized as an operating lease according to GAAP, and that the leases in question were tied to cancelable funding because they included clauses permitting termination upon cancellation or reduction of funding.

In addition, Southwest Key stated that it had an independent third party analyze the leases to determine the interest rate, fair market value, and term of lease payments and that the third party's analysis yields substantially different results from ours. Southwest Key stated that our use of the *Wall Street Journal* prime rate (3.25 percent or 3.5 percent, depending on the lease inception), as the interest rate is not applicable to these leases because of the risk inherent in operating the shelters. According to the independent third party, it would be more appropriate to use an interest rate established by commercial lending sources, which is currently closer to 6 percent. In addition, Southwest Key stated that our valuation of the properties using tax-assessed property values was significantly less than the actual fair value of the properties based on independent appraisals.

Finally, Southwest Key stated that, because it includes a termination clause in its leases for shelters to limit its financial liability should Government funding cease, it is reasonable to use a lease term no greater than 36 months on the properties rather than the 10-year lease term we used.

Office of Inspector General Response

Southwest Key's position that any lease tied to cancelable funding is characterized as an operating lease according to GAAP because of the existence of a fiscal funding clause is not applicable because the definition of a fiscal funding clause is tied to governmental units, and Southwest Key is not a governmental unit.[26]

For the interest rate in our capital lease analysis, we used the prime rate, which is defined by the *Wall Street Journal* as "the base rate on corporate loans posted by at least 70% of the 10 largest U.S. banks."[27] We used the prime rate because the lessee's incremental borrowing rate[28] was unknown. Southwest Key did not provide the independent third party's analysis of

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[26] For financial reporting purposes, to be considered a government, an organization has to meet one or more of the following characteristics: popular election of officers or appointment of a controlling majority of the members of the organization's governing body by officials of one or more State or local governments, potential for unilateral dissolution by a government with net assets reverting to the government, or the power to enact and enforce a tax levy (FASB).

[27] HSH website at www.hsh.com/indices/prime-rate.html (accessed on August 19, 2020).

[28] The incremental borrowing rate is the rate that, at lease inception, the lessee would have incurred to borrow over a similar term the funds necessary to purchase the leased asset (FASB 840-10-20).

borrowing rates for similar operations. Without that analysis, we maintain that our use of the prime rate was appropriate.

For the property valuation, the minimum lease payment calculation requires the fair value of the leased property at the inception of the lease. During our audit, we inquired whether Southwest Key had conducted any market rate analysis at the inception of the leases and were told by a Southwest Key official that it had not. Therefore, we used the tax-assessed values at the inception of the lease, because this was the only historical information available. In its comments, Southwest Key did not indicate the date associated with the appraised values the independent third party used. Therefore, we do not know whether the appraised values in Southwest Key's analysis reflect current values or the values at the leases' inception.

GAAP uses the lease term in determining the minimum lease payments for classification as a capital lease and does not address a reduction in lease term, because of a termination clause, in calculating the present value of the minimum lease payments. Therefore, because the lease term was 10 years, it would not be consistent with GAAP to use 36 months as suggested by Southwest Key.

After considering Southwest Key's comments, we maintain that our use of the prime rate, the tax-assessed property values, and 10-year lease terms is valid.

SOUTHWEST KEY CLAIMED UNALLOWABLE RENTAL COSTS FOR A RELATED-PARTY LEASE

Southwest Key Comments

Southwest Key stated that the costs associated with the related-party lease have been refunded to ACF. Additionally, Southwest Key stated that shelter operations at this location were relocated and the lease terminated.

SOUTHWEST KEY CLAIMED UNALLOWABLE COMMON AREA MAINTENANCE FEES

Southwest Key Comments

Southwest Key partially agreed with our finding on CAM charges and stated that the charges were reconciled at least annually, and any overcharges resulting from the reconciliation are credited back to the subsequent month's amount due. According to Southwest Key, this practice met the requirements of its documentation obligations.

Southwest Key stated that it reviewed the underlying charges for the four leases in question and that while it determined most of the charges were reasonable and allowable, it identified charges that did not have prior approval or were missing documentation. According to Southwest Key, based on its review, $1,867,498 of the $2,342,522 in questioned direct costs was allowable.

In addition, Southwest Key stated that it does not believe indirect costs should be questioned and that "where the existence of the underlying base cost and the base cost's direct allocability is established, whether the base cost is technically an 'allowable' or 'unallowable' cost has no impact on calculation or application of an entity's indirect cost rate."

Southwest Key stated that it will refund to the Federal Government $475,025 for the CAM fees that it determined were unallowable, change its annual CAM review process from annual to quarterly, and regularly inspect underlying transactional data to ensure that the costs are adequately documented and reasonable. Further, Southwest Key met with the relevant landlords to reemphasize the nature of allowable CAM charges.

Office of Inspector General Response

Although Southwest Key considered our recommendation and performed its own review of CAM fees, Southwest Key did not provide any supporting information on how it determined the $1,867,498 was allowable. Because Southwest Key did not provide any documentation to support the amount of CAM fees it determined to be allowable, we have not made any changes to our determination of unallowable CAM fees.

We agree with Southwest Key's statement pertaining to indirect costs, that "whether the base cost is technically an 'allowable' or 'unallowable' cost has no impact on calculation or application of an entity's indirect cost rate." However, the calculation of the indirect cost rate is irrelevant to our recommended refund of $337,323 in indirect costs. Our recommendation is based on the application of the indirect cost rate to the direct costs we determined were unallowable. The total cost of a Federal award is the sum of allowable direct costs and allocable indirect costs less any applicable credits. (45 CFR § 75.402). If a direct cost is unallowable, then indirect costs claimed pursuant to that cost are unallowable, as they are not allocable to the award.

SOUTHWEST KEY CLAIMED UNALLOWABLE COSTS FOR ADDITIONAL RENT

Southwest Key Comments

Southwest Key disagreed with our finding, explaining the additional rent[29] payments were related to "making the facilities ready for UAC shelter program purposes." Southwest Key stated that it is a difficult, almost impossible task to find "turn-key facilities" that provide a living space for children that meets Federal, State, and local standards. Further, Southwest Key stated that landlords require the prospective tenant to cover the related costs for the preparation of a facility. In addition, Southwest Key stated that it will discontinue the practice of including "additional rents" in future leases.

[29] Southwest Key uses the term "one-time lease payments" in its comments on our draft report.

Office of Inspector General Response

Although we acknowledge that the task of finding appropriate living space for the UAC Program is difficult, Southwest Key did not provide documentation to support the cost for renovation of facilities. The lease did not specify the purpose of the additional rent payments, and Southwest Key was unable to provide supporting documentation to show these payments were allocable to the UAC Program.

Southwest Key stated that it will discontinue the practice of including "additional rents" in future leases. However, even if the additional rents are removed from future leases, if Southwest Key is going to charge these types of costs to a Federal award, it must maintain adequate documentation to support that the costs are allowable. Furthermore, given Southwest Key's statements about the difficult task of finding "turn-key facilities" and landlords requiring the prospective tenant to cover the cost of preparing facilities, we emphasize that any costs for improvements to buildings that qualify as capital expenditures (which materially increase the buildings' value or useful life) are unallowable as direct costs except with the prior written approval of ORR.

SOUTHWEST KEY CLAIMED UNALLOWABLE INFLUX BONUSES

Southwest Key Comments

Southwest Key disagreed with our finding on influx bonuses, stating that the bonuses were reasonable and necessary. Southwest Key said the bonuses were to reward and retain staff for long hours imposed by the influx that occurred during the 2015−2016 period. Southwest Key stated that it made a management decision to compensate employees accordingly, pursuant to the terms of the influx bonus policy in Southwest Key's Operations Manual.

In its comments, Southwest Key cited four extraordinary conditions that existed during the influx period that influenced its decision to pay bonuses to employees impacted by the influx. According to Southwest Key: (1) employees at UAC shelters worked unusually long hours due to the influx (an increase of 8 percent from FY 2015 to FY 2016), (2) bed capacity increased 46 percent between September 2015 to September 2016, (3) the number of UAC clients serviced during the influx period increased significantly, and (4) high employee turnover during the influx exacerbated work requirements for the remaining employees. Southwest Key asserted the bonuses were reasonable and appropriate under the unique conditions and were in line with employees' expectations given past practices.

Office of Inspector General Response

Southwest Key did not follow its established incentive compensation plan as required by 45 CFR § 75.430(f). Southwest Key's policy states that the influx bonus may be earned based on "the level of individual effort." Because it didn't document the individual effort of the employees who received bonuses, Southwest Key failed to support the 20-percent bonuses paid to 358 employees.

SOUTHWEST KEY PAID SIX EMPLOYEES EXCESSIVE EXECUTIVE COMPENSATION

Southwest Key Comments

Southwest Key disagreed with our finding on executive compensation, stating that during our audit period Southwest Key had a predetermined cost rate. According to Southwest Key, costs that are funded under a predetermined cost rate are not required to be expended in accordance with Federal "allowable cost" restrictions, whether under cost principles or through an appropriations rider. Southwest Key confirmed the executive salaries in question were charged to UAC awards indirectly through the application of this predetermined rate.

Office of Inspector General Response

The appropriations rider and the Funding Opportunity Announcement for the UAC Program relevant to the funds awarded to Southwest Key during our audit period both contain language stating that Federal funds shall not be used to pay the salary of an individual at a rate in excess of Executive Level II. We maintain that "funds" includes all funds (direct and indirect) that are derived from the grant awarded for Southwest Key's UAC Program.

SOUTHWEST KEY'S BONUS POLICY COULD ALLOW FOR UNREASONABLE BONUSES

Southwest Key Comments

Southwest Key disagreed with our finding on its bonus policy, stating that it cannot be more specific in its public bonus policy because "it would have the effect of setting bonus expectations in the employee base and limit [its] flexibility with respect to making bonus/compensation decisions that reflected the current business conditions." Southwest Key also said that even though its policy is silent on percentage, it uses a Compensation Committee that directs compensation and bonus strategies on an annual basis and that committee has set a fair-market-based bonus ceiling over the past 2 years. According to Southwest Key, the Compensation Committee declares when and if a bonus will be awarded based on availability of funds, among other criteria. In addition, Southwest Key stated that it uses two independent third parties to confirm the fair-market percentage for its bonus structure.

Office of Inspector General Response

During our audit, Southwest Key did not offer any information about the use of the Compensation Committee and third parties to determine or set bonus practices. In its comments, Southwest Key did not provide documentation to support the basis of its committee's fair-market-based bonus ceiling. Without an understanding of how Southwest Key sets its bonus ceiling, our position remains that bonuses paid with Federal funds could exceed the amount that would be incurred by a prudent person, considering their responsibilities to the Federal Government, and thus be unreasonable.

SOUTHWEST KEY CLAIMED OTHER UNALLOWABLE COSTS

Southwest Key Comments

Southwest Key partially agreed with our finding on unallowable costs, stating that it had reviewed underlying documentation and does not contest $16,201 in questioned costs. For the remaining $123,642, Southwest Key states that it has: (1) thorough support of its worker's compensation rate, including methodology of how the rate was calculated; (2) earning statements and enrollment documents verifying health insurance charges; (3) support for a salary underpayment; and (4) hourly wage support and earning statements for several salary charges.

Office of Inspector General Response

During the audit, we made several attempts to obtain the supporting documents; however, Southwest Key did not provide them. Therefore, we are not changing our conclusion that the remaining $123,642 is unallowable.

SOUTHWEST KEY DID NOT ADEQUATELY SAFEGUARD FEDERAL FUNDS

Southwest Key Comments

Southwest Key did not agree with our finding on safeguarding Federal funds, stating that its processes "effectively trace the flow of funds and ensure that [F]ederal funds are used only for [F]ederal purposes." Southwest Key asserted that it has the ability to trace and quantify each of its cash flows to accomplish this requirement. However, Southwest Key mentioned that its financial leadership met to diagram bank flows to make it easier to describe its complex banking operations and that Southwest Key will continue to analyze potential improvements in how it directs funds through its accounting and banking systems.

Office of Inspector General Response

Although we found Southwest Key's flowchart to be an accurate depiction of the flow of Federal funds, it does not provide adequate documentation showing that Federal funds were being used solely and completely for the UAC Program. Our position remains that Southwest Key's journal entries tracked the expense, not the source of the funds. However, we commend Southwest Key for its action plan and willingness to continue to analyze potential improvements in how it directs funds through its accounting and banking systems.

SOUTHWEST KEY WAS UNABLE TO SUPPORT EXPENSES AND THE INDIRECT COST BASE ON ITS FEDERAL FINANCIAL REPORTS

Southwest Key Comments

Southwest Key partially agreed with our finding on expenses, stating that it was able to provide a summary trial balance report from its accounting system used for compiling and submitting FFRs at the time they were due. Southwest Key acknowledged that the detailed trial balance we requested did not match the summary version or support the FFR amounts. Southwest Key recognized this as an issue and stated that the difference in the reported amounts was due to additional entries and adjustments after the books were closed.

Southwest Key stated that it has improved several processes, including the month-end and year-end closeout processes. Southwest Key stated that entries to closed periods are no longer allowed without prior management approval. In addition, Southwest Key said a detailed trial balance report, instead of a summary version, is now generated and saved at the time the FFRs are compiled to satisfy audit requirements.

Office of Inspector General Response

Although Southwest Key could not locate the file containing the documentation to support the expenses reported on the FFR, we commend Southwest Key for its action plan to improve its processes and its willingness to continue to identify areas for improvement.

SOUTHWEST KEY DID NOT RECORD FIXED ASSETS TIMELY

Southwest Key Comments

Southwest Key agreed with our finding on fixed assets and described corrective actions taken to address it. For example, Southwest Key stated that it has implemented a process of regularly reviewing all transactions to identify any expenditures that meet or exceed the capitalization threshold of $5,000, and identified transactions are capitalized and entered into Southwest Key's asset management database.

Office of Inspector General Response

We commend Southwest Key for its action plan to implement a process for ensuring the proper and timely recording of fixed assets.

ACF COMMENTS

In written comments on our draft report, ACF generally concurred with five of the recommendations and acknowledged the sixth recommendation, stating that it will work with HHS Cost Allocation Services to ensure that Southwest Key is adhering to statutory limitations on executive compensation. In addition, ACF stated that it will take into consideration the work performed and the recommendations made by OIG to determine a final resolution of

Southwest Key's grant management performance. ACF's comments are included in their entirety as Appendix G.

APPENDIX A: AUDIT SCOPE AND METHODOLOGY

SCOPE

Our audit covered $184.8 million in general ledger financial transactions from October 1, 2015, through September 30, 2016 (audit period). We selected a stratified random sample of 1,200 financial transactions totaling $25,179,084 (net)[30] for review. We performed our fieldwork at Southwest Key in Austin, Texas, from June 2017 through April 2019. Our objective did not require an understanding of all Southwest Key's internal controls. We limited our assessment to Southwest Key controls related to its financial management system.

METHODOLOGY

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and guidance;
- reviewed grant documents;
- reviewed Southwest Key's accounting policies and procedures and organizational structure;
- interviewed Southwest Key officials to gain an understanding of their policies and procedures related to the UAC Program;
- reconciled the FFRs with Southwest Key's general ledgers;
- reconciled the drawdown amounts with Payment Management System reports;
- reviewed lease agreements for all facilities;
- selected a stratified random sample of 1,200 financial transactions from a sampling frame of 24,851 transactions, totaling $184,845,038, that Southwest Key charged to its grant during our audit period (Appendix D);
- reviewed supporting documentation for each sampled transaction;
- estimated the total unallowable costs Southwest Key submitted for Federal reimbursement during our audit period (Appendix E);
- calculated indirect costs related to unallowable direct costs; and

[30] Debit transactions reviewed totaled $27,610,612, and credit transactions reviewed totaled $2,431,528.

- discussed our findings with Southwest Key and ACF officials.

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

APPENDIX B: RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Report Title	Report Number	Date Issued
Southwest Key Did Not Have Adequate Controls in Place To Secure Personally Identifiable Information Under the Unaccompanied Alien Children Program	A-18-18-06001	8/15/2019
Southwest Key Programs Did Not Always Comply With Health and Safety Requirements for the Unaccompanied Alien Children Program	A-06-17-07005	8/15/2019
The Children's Village, Inc., an Administration for Children and Families Grantee, Did Not Always Comply With Applicable Federal and State Policies and Requirements	A-02-16-02013	4/26/2019
Lincoln Hall Boys' Haven, an Administration for Children and Families Grantee, Did Not Always Comply With Applicable Federal and State Policies and Requirements	A-02-16-02007	2/11/2019
BCFS Health and Human Services Did Not Always Comply With Federal and State Requirements Related to the Health and Safety of Unaccompanied Alien Children	A-06-17-07007	12/6/2018
Florence Crittenton Services of Orange County, Inc., Did Not Always Claim Expenditures in Accordance With Federal Requirements	A-09-17-01002	10/15/2018
Heartland Human Care Services, Inc., Generally Met Safety Standards, but Claimed Unallowable Rental Costs	A-05-16-00038	9/24/2018
Florence Crittenton Services of Orange County, Inc., Did Not Always Meet Applicable Safety Standards Related to Unaccompanied Alien Children	A-09-16-01005	6/18/2018
BCFS Health and Human Services Did Not Always Comply With Federal Requirements Related to Less-Than-Arm's-Length Leases	A-06-16-07007	2/20/2018
Office of Refugee Resettlement Unaccompanied Alien Children Grantee Review—His House	A-04-16-03566	12/4/2017

APPENDIX C: FEDERAL, ACCOUNTING, AND SOUTHWEST KEY REQUIREMENTS

FEDERAL REQUIREMENTS

45 CFR Part 75 Uniform Administrative Requirements, Costs Principles, and Audit Requirements for HHS Awards

45 CFR § 75.302 Financial management and standards for financial management systems

(b) The financial management system of each non-Federal entity must provide for the following:

(2) Accurate, current, and complete disclosure of the financial results of each Federal award or program in accordance with the reporting requirements set forth in §§ 75.341 and 75.342. If an HHS awarding agency requires reporting on an accrual basis from a recipient that maintains its records on other than an accrual basis, the recipient must not be required to establish an accrual accounting system. This recipient may develop accrual data for its reports on the basis of an analysis of the documentation on hand. Similarly, a pass-through entity must not require a subrecipient to establish an accrual accounting system and must allow the subrecipient to develop accrual data for its reports on the basis of an analysis of the documentation on hand.

(3) Records that identify adequately the source and application of funds for federally funded activities. These records must contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest and be supported by source documentation.

(4) Effective control over, and accountability for, all funds, property, and other assets. The non-Federal entity must adequately safeguard all assets and assure that they are used solely for authorized purposes.

45 CFR § 75.361 Retention requirements for records

Financial records, supporting documents, statistical records, and all other non-Federal entity records pertinent to a Federal award must be retained for a period of 3 years from the date of submission of the final expenditure report or, for Federal awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report, respectively, as reported to the HHS awarding agency or pass-through entity.

45 CFR § 75.400 Policy Guide

(d) states in part that the accounting practices of the non-Federal entity must provide for adequate documentation to support costs charged to the Federal award.

45 CFR § 75.403 Factors affecting allowability of costs

Except where otherwise authorized by statute, costs must meet the following general criteria in order to be allowable under Federal awards: (a) be necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles; (b) conform to any limitations or exclusions set forth in these principles or in the Federal award as to types or amount of cost items; and (g) be adequately documented.

§75.404 Reasonable costs.

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when the non-Federal entity is predominantly federally funded. In determining reasonableness of a given cost, consideration must be given to:

(d) Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the non-Federal entity, its employees, where applicable its students or membership, the public at large, and the Federal Government.

45 CFR § 75.405 Allocable costs

(a) A cost is allocable to a particular Federal award or other cost objective if the goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received. This standard is met if the cost:

(1) is incurred specifically for the Federal award;

(2) benefits both the Federal award and other work of the non-Federal entity and can be distributed in proportions that may be approximated using reasonable methods; and

(3) is necessary to the overall operation of the non-Federal entity and is assignable in part to the Federal award in accordance with the principles in this subpart.

45 CFR § 75.408 Limitation on allowance of costs.

The Federal award may be subject to statutory requirements that limit the allowability of costs. When the maximum amount under a limitation is less that the total amount determined in accordance with the principles in this part, the amount not recoverable under the Federal award may not be charged to the Federal award.

45 CFR § 75.430 Compensation–personal services.

(d) Unallowable costs.

(2) The allowable compensation for certain employees is subject to a ceiling in accordance with statute.

(f) Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., is allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the non-Federal entity and the employees before the services were rendered, or pursuant to an established plan followed by the non-Federal entity so consistently as to imply, in effect, an agreement to make such payment.

45 CFR § 75.436 Depreciation

(c) The computation of depreciation must be based on the acquisition cost of the assets involved and must exclude:

(1) the cost of land.

45 CFR § 75.465 Rental cost of real property and equipment

(b) Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed had the non-Federal entity continued to own the property. This amount would include expenses such as depreciation, maintenance, taxes, and insurance.

(c) Rental costs under "less-than-arms-length" leases are allowable only up to the amount (as explained in paragraph (b) of this section). For this purpose, a less-than-arm's-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other.

(1)(2)(3) Such leases include, but are not limited to those between divisions of the non-Federal entity; the non-Federal entity under common control through common officers, directors, or members; and the non-Federal entity and a director, trustee, officer, or key employee of the non-Federal entity or an immediate family member, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

(5) Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount (as explained in paragraph (b) of this section) that would be allowed had the non-Federal entity purchased the property on the date the lease agreement was executed. The provisions of GAAP must be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in § 75.449. Unallowable costs include amounts paid for profit, management fees, and taxes that would not have been incurred had the non-Federal entity purchased the property.

Consolidated Appropriations Act, 2016 (HHS Appropriations Bill)

Division H–Departments of Labor, Health and Human Services and Education, and Related Agencies Appropriations Act, 2016, Title V, General Provisions, Sect. 202:

"None of the funds appropriated in this title shall be used to pay the salary of an individual, through a grant or other extramural mechanism, at a rate in excess of Executive Level II."

OFFICE OF REFUGEE RESETTLEMENT REQUIREMENTS

Funding Opportunity Announcement HHS-2015-ACF-ORR-ZU-0833

> "Award funds issued under this announcement may not be used to pay the salary, or any percentage of salary, to an individual at a rate in excess of Executive Level II."
>
> "Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions, are considered unallowable costs under grants or cooperative agreements awarded under this funding opportunity announcement."

ACCOUNTING STANDARDS (GAAP)

Accounting Standards Update 2016-02

- If a lease agreement contains any of the four criteria, the lessee records the lease as a capital lease. The criteria that Southwest Key meets is:

  Present Value—The present value of the minimum lease payments required under the lease is at least 90 percent of the fair value of the asset at the inception of the lease.

SOUTHWEST KEY POLICIES AND PROCEDURES

Operations Manual for Unaccompanied Minor Programs, revised March 2015, "Bonus Structure Purpose and Policy Statement"

> The bonus structure is applicable to all management and non-management employees in the unaccompanied minors program. All bonuses are awarded based on the categories listed in Southwest Key's *Operations Manual for Unaccompanied Minor Programs* and as funds permit in that FY.
>
> Southwest Key recognizes during the influx season staff are called upon to help expand bed capacity for the company. Depending on the level of the individual staff effort, the employee may earn a certain percentage of their base salary as a bonus for these influx efforts, subject to the availability of funds in that FY's budget. The bonus amount will be suggested by the Program Director and approved by the Regional Executive Director and the Vice President (VP) or Associate VP. Employees are eligible for this bonus if they fall into one of three categories: (1) Volunteers at Home; (2) Assist in Expansion; (3) Assist in Program Launch. (*Operations Manual for Unaccompanied Minor Programs*, revised March 2015, section 4.03)

APPENDIX D: STATISTICAL SAMPLING METHODOLOGY

SAMPLING FRAME

We received an Excel file from Southwest Key that contained 128,064 transactions totaling $201,471,579, which Southwest Key had recorded as expenditures during from October 1, 2015, through September 30, 2016, for all three of its UAC grants. We used accounting system identifiers to manually match general ledger expenditure transactions that netted to zero. We also removed National School Breakfast and Lunch program transactions, transactions moved to non-Federal funds, transactions valued between ($1,000) and $1,000 (both debits and credits), and transactions selected as part of our probe sample. As a result, our sampling frame contained 24,851 transactions totaling $184,845,038.[31]

SAMPLE UNIT

The sample unit was a general ledger expenditure transaction.

SAMPLE DESIGN AND SAMPLE SIZE

We used a stratified random sample. The sampling frame was divided into seven strata. Strata 1 through 3 were based on monetary thresholds (salary and wage items, purchases, supplies, contract labor, etc.), stratum 4 consisted of salary and wage transactions identified by Southwest Key as yearend bonuses, stratum 5 consisted of building/property leases, stratum 6 consisted of transactions incurred on the last day of the FY, and stratum 7 contained salary accrual transactions.

[31] Our sample covered all 24,851 transactions in our sampling frame but did not cover all $184,845,038 in line items associated with these transactions. For each salary and wage transaction, we reviewed the six highest dollar line items or the top 10 percent of the dollar line items, whichever was greater. The dollar value associated with any salary line items that did not meet these conditions were considered to be low risk and were treated as allowable for the purpose our statistical estimate.

Table 2: Sample Design and Sample Size

Stratum #	Frame Count	Frame Total	Stratum Description	Sample Size
1	17,943	$45,281,882	Transactions less than $7,793	50
2	3,590	55,301,887	Transactions greater than $7,795 and less than $39,624	50
3	665	53,722,569	Transactions greater than $39,630 and not included in strata 4 through 7	50
4	358	3,414,776	Yearend bonuses	358
5	613	15,476,699	Building property leases	613
6	1,633	10,578,750	Transactions incurred on the last day of the FY	30
7	49	1,068,477	Salary accruals	49
Total	**24,851**	**$184,845,038***		**1,200**

* Differences in the frame count and frame total are due to rounding.

For strata 1 through 3, most of the sample items are salary and wage transactions. These transactions, which we considered low risk, had multiple line items that made up the transactions. Because of the low risk of these transactions, we selected the six highest dollar line items or the top 10 percent of the dollar line items, whichever was greater, to review.

SOURCE OF RANDOM NUMBERS

We used the Office of Inspector General, Office of Audit Services (OIG/OAS), statistical software to generate the random numbers.

METHOD OF SELECTING SAMPLE ITEMS

We consecutively numbered the transactions in strata 1, 2, 3, and 6. After generating the random numbers for these strata, we selected the corresponding frame items. We reviewed all transactions in strata 4, 5, and 7.

ESTIMATION METHODOLGY

We used the OIG/OAS statistical software to estimate the total amount of any expenditure transactions that were unallowable.

APPENDIX E: SAMPLE RESULTS AND ESTIMATES

Table 3: Sample Details and Results

Stratum	Frame Size (Expenditure Transactions)	Value of Frame	Sample Size	Value of Sample	Number of Unallowable Expenditure Transactions in Sample	Value of Unallowable Expenditure Transactions in Sample
1	17,943	$45,281,882	50	$118,018	0	$0
2	3,590	55,301,887	50	733,067*	1	16,968
3	665	53,722,569	50	4,191,371†	5	106,867
4	358	3,414,776	358	3,414,776	281	3,264,782
5	613	15,476,699	613	15,476,699	135	6,746,090
6	1,633	10,578,750	30	176,676	5	16,007
7	49	1,068,477	49	1,068,477	0	0
Totals	**24,851**	**$184,845,038‡**	**1,200**	**$25,179,084‡**	**427**	**$10,150,715**

* Because of the methodology used to review salary and wage transactions with multiple line items, $123,507.58 of this stratum was not reviewed and was treated as allowable for the purpose of our estimate.

† Because of the methodology used to review salary and wage transactions with multiple line items, $3,151,144.09 of this stratum was not reviewed and treated as allowable for the purpose of our estimate.

‡ Differences in the frame count and frame total are due to rounding.

Table 4: Estimated Value of Unallowable Expenditure Transactions
(Limits Calculated at the 90-Percent Confidence Interval)

Estimate Description	Lower Limit	Point Estimate	Upper Limit
Amount of unallowable expenditures	$10,879,121‡	$13,521,876‡	$16,164,631‡

‡ Includes unallowable amounts for which ACF has requested recovery.

APPENDIX F: SOUTHWEST KEY COMMENTS

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National Headquarters
6002 Jain Lane, Austin, Texas 78721

phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

June 17, 2020

Report Number: A-06-17-07004

Transmitted by email (Patricia.Wheeler@oig.hhs.gov)

Patricia Wheeler
Regional Inspector General for Audit Services
Office of Audit Services, Region VI
Office of Inspector General
1100 Commerce Street, Room 632
Dallas, TX 75242

Dear Mrs. Wheeler:

Enclosed is a formal response from Southwest Key (SWK) to the draft report transmitted to SWK on March 23, 2020 from the U.S. Department of Health and Human Services' Office of Inspector General (OIG) entitled *Southwest Key Programs Failed to Protect Federal Funds Intended for the Care and Placement of Unaccompanied Alien Children* (the "Draft Report"). In the Draft Report, the OIG details recommendations arising from an audit of SWK's financial transactions for fiscal year 2016. We are grateful for the opportunity to submit this response to the recommendations and findings in the Draft Report.

We appreciate your time and input and understand the good work that the OIG does. We value the process of inspection and audit, and we would like to assure you that the audit has prompted SWK to take actions to improve its policies and processes so that we can continue to provide needed services and be good stewards of federal funds. As we continue to provide highly-rated[1] and accredited services[2] to the youth we serve, we hope to continue partnering with the Office of Refugee Resettlement (ORR).

We'd also like to convey that as we assessed the various points discussed in the Draft Report and summarized our response in the framework of this letter, we are sensitive

[1] We recently received high marks from the Child Welfare Consulting Group who assessed 17 of our shelters

[2] We are accredited by the Council on Accreditation ("COA")

1

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phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

to the fact that there is great disparity between our findings. We have great respect for the points you've highlighted, but we do feel the analysis we've done as a result of your findings provides additional clarity that may help to better communicate integral information that we hope weighs in your final decision.

This letter is organized under headings that mirror the findings in the Draft Report, followed by narratives describing our responses for each issue. We have included supporting graphs, tables, and documentation as appendices to this letter.

Sincerely,

Joella L. Brooks
Southwest Key Programs
Interim CEO

southwest key programs
National Headquarters
6002 Jain Lane, Austin, Texas 78721
phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

**Questioned Costs for Leases –
Capital Leases**

The OIG's auditors (Auditors) classified six SWK leases as *capital* leases. This classification limits SWK to charging its federal grants for the costs of ownership: depreciation, maintenance, taxes, and insurance. In the Draft Report's noted cases, these costs sum to much less than SWK's incurred lease payments.

To begin, U.S. generally accepted accounting principles (GAAP) contain a special provision specifically for leases with termination clauses, such as the SWK leases at issue, whose termination may be triggered by the cancelation or reduction of funding (see the subsection below on Lease Payment Terms). Per GAAP, the presence of a lease containing a fiscal funding clause whose exercise is anything more than remote makes the lease an *operating* lease rather than a *capital* lease:

> ASC 840-10-20 Glossary
>
> Fiscal Funding Clause – A provision by which the lease is cancelable if the legislature or other funding authority does not appropriate the funds necessary for the governmental unit to fulfill its obligations under the lease agreement.
>
> ASC 840-10-25-3 Lease Term Criterion
>
> The lease term criterion in paragraph 840-10-25-1(c) addresses the lease term. The existence of a fiscal funding clause in a lease agreement requires an assessment of the likelihood of lease cancellation through exercise of the fiscal funding clause. If the likelihood of exercise of the fiscal funding clause is assessed as being remote, a lease agreement containing such a clause shall be considered a noncancelable lease; otherwise, the lease shall be considered cancelable and thus classified as an operating lease.

Regardless whether SWK is appropriately considered a governmental unit (and there are good arguments that it functions as such), it is nonetheless reasonable to conclude that any lease tied to cancelable funding is appropriately characterized as an *operating* lease under GAAP. That conclusion is further supported as to these leases by the limited benefit SWK receives from the properties. SWK does not own any of the identified properties and has no use for them other than for performing services on behalf of the government. SWK maintains zero capital benefit from the properties, and indeed they provide no benefit to SWK other than enabling it to provide the services with which SWK is entrusted.

Further, the Auditors used several key factors that do not fully take into consideration market-based data used in the threefold classification analysis under GAAP whereby the present value of the rents must be less than 90% of the fair value of the property. Specifically, the Auditors used the following non-market-based key factors in their model: (1) low-risk interest rates; (2) long-term leases that did not reflect the realities of the 90-day lease termination provisions that exist in shelter leases; and (3) non-market-based property valuations for the properties in question.

Interest Rate

The Auditors used a low-risk interest rate to arrive at the present value of future minimum payments. Specifically, the Auditors used the Wall Street Journal Prime Rate. This interest rate is not applicable to these leases given the risk inherent in operating Unaccompanied Alien Children (UAC) shelters. SWK received third-party independent analysis from the accounting firm Briggs & Veselka Co. (BV), confirming that, for such leases, it is more appropriate to use rates established by commercial lending sources. Those rates are closer to 6%. Per BV:

> Based on clients with similar operations, BV notes that a 6% borrowing rate is reasonable.[3]

[3] From a, August 2, 2019 BV report on lease classification.

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Table 1 summarizes both the Auditors' utilized interest rates and the alternative rate from the independent accounting firm.

Table 1: Comparison of Discount Rate used - Auditors vs Third-Party

	Per Wall Street Journal Prime Rate (used by auditors)	Per Independent Third-Party
Discount Rate (Incremental Borrowing Rate)	3.25 - 3.50%	6.00%

Property Valuations

Additionally, the Auditors used tax-assessed property values as the fair value of the properties in their analysis. As depicted in Table 2, SWK has received third-party independent appraisals of comparable valuations in the area – the typical market valuation approach when buying or selling properties – illustrating that the tax-roll valuations that the Auditors used are significantly less than the actual fair value of properties.

Table 2: Comparison of Fair Values - Auditors vs Third-Party

Facility*	Property Value Per county tax assessment (used by Auditors)	Property Value Per independent appraisal (using comp sales approach)
A	\$1,122,457	\$5,500,000 *(4.9 x higher)*
C	\$1,020,356	\$1,850,000 *(1.8 x higher)*
D	\$481,966	\$4,300,000 *(9.0 x higher)*
E	\$3,940,075	\$13,655,000 *(3.5 x higher)*
F	\$2,116,795	\$14,860,000 *(7.0 x higher)*

*Facility B is excluded from the analysis. As the auditors noted in their report the lease was terminated due to findings communicated by the ACF in 2019.

Lease Payment Terms

Finally, the Auditors used a lease term of ten years for rent payments in their calculations. But each of the leases in question contains a 90-day termination clause in the event SWK loses funding:

> [T]he tenant has the right to terminate the lease at any time after the expiration of the second year of the Term, or any modification, extension or renewal term…hereof, upon issuance of 90 days written notice . . . in the event funding for the program to be conducted by the Tenant within the Premise is reduced, reallocated, terminated or otherwise modified so as to render the award for the program insufficient for the commercially reasonable operation of the Tenant's program.

SWK includes this clause in its leases for shelters for the UAC Program in order to limit SWK's financial liability should the government cease future funding. Additionally, government funding is exclusively year-to-year. In fact, the cooperative agreements with ORR are 36-month awards, with only one year's funding assuming availability of funds.

This uncertain funding source effectively limits the leases to very short terms, such as annual terms, rather than the Auditors' posited ten-year terms.

BV provides another perspective:

> "[D]ue to the independent funding decisions of the federal government funding programs, it is our belief the only fixed non-cancelable period is the period up until the company is allowed to terminate the lease agreement," and therefore "[it] is our assessment that the lease term for purposes of this 'capitalization' test is two years and 90 days."

In summary, it is reasonable to use a 12-month, 24-month, or even a 36-month lease term on the properties at issue. Each of these terms are in line with sound support from independent third parties.

Conclusion

The Auditors' suggested approach is inconsistent with GAAP and will, as a practical matter, cause great harm across the ORR's shelter program because (1) the program is funded only year to year, and (2) has very high and detailed standards for facility quality and features. If the Auditors' conclusion that these leases are *capital* leases stands, it will create substantial downward pressure on the quality of facilities across the program. The Auditors' analysis and proposed classifications would subject SWK to such onerous restrictions that locating and operating suitable and licensable facilities for the UAC Program would be effectively impossible.

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phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

Table 3 illustrates the substantial difference between the Auditors' approach and an independent third-party analysis using the above parameters for one of the subject leases (that of Facility F). Applying the independent third-party analysis to each of the other leases yields similar results. See Appendix 1 for the classification analysis

Table 3 - 90% Test Auditors vs Independent Third Party
Facility F

Auditor Analysis

Incremental Borrowing Rate	3.50%
Lease Term (Years)	10

Year	Lease Payment	Discounted Lease Payment
1	1,512,500	$1,461,353
2	1,140,000	$1,064,202
3	1,162,800	$1,048,779
4	1,186,056	$1,033,579
5	1,209,777	$1,018,600
6	1,233,973	$1,003,838
7	1,258,652	$989,289
8	1,283,825	$974,952
9	1,309,502	$960,822
10	1,335,692	$946,897
	Total	$10,502,310

vs

Fair Value (Tax Records)	$2,116,795
Greater than 90% = ***Capital Lease*** >>	**496%**

Independent Third-Party Analysis

Incremental Borrowing Rate	6.00%
Lease Term (Years)	2

Year	Lease Payment	Discounted Lease Payment
1	1,512,500	$1,426,887
2	1,140,000	$1,014,596
	Total	$2,441,483

vs

Fair Value (Appraisal)	$14,860,000
Less than 90% = ***Operating Lease*** >>	**16%**

of the remaining four leases.

As you can see, the application of correct lease terms, borrowing rates, and fair-market valuations yields vastly different values. For Facility F, the independent third-party analysis yields a 16% present value compared to the 496% present value in the Auditors' analysis – a huge difference.

Given the data presented above, SWK respectfully asserts that these leases should remain classified as *operating* leases, and that SWK is entitled to the full lease payments it incurred under the respective lease agreements.

Action Plan

SWK will continue to apply the threefold classification analysis as noted in Table 3 (interest rate, lease term, and property market value) to its leases to confirm they fall below the 90% present value threshold. Further, SWK will continue to formally manage this process and record pertinent data, such as property appraisals and local commercial interest rates, to provide clarity and transparency to any future inspections of these lease matters.

Questioned Costs for Leases –
Related Party Lease

The Administration for Children and Families (ACF) issued a notice of Monetary Disallowance to SWK in July 2019 that included some of the same costs as those questioned in the Draft Report for a related-party lease in the amount of $233,684 in direct costs and $33,650 in associated indirect costs. SWK has refunded the costs associated with the related-party, terminated the lease, and relocated shelter operations.

Questioned Costs for Leases –
Common Area Maintenance Charges

Several of SWK's lease agreements for UAC shelters require SWK to reimburse the landlords for Common Area Maintenance (CAM) charges to cover operation, management, and maintenance of the leased facilities. The Auditors have questioned the payments due to inadequate documentation. The Auditors state that since these costs are not sufficiently documented there is no assurance to their reasonableness or necessity. As a result, the Auditors have questioned all CAM charges.

Per the lease agreements SWK has with landlords, CAM fees are reimbursements for the landlords' actual, relevant costs, and are required to be reconciled at a minimum on an annual basis. As part of our lease obligations, SWK performed annual reconciliations of actual CAM charges and credited back to the funder any overcharges in the form of credits to the subsequent month's amount due. SWK understood that this practice of reconciling payments for CAM-to-actual charges incurred by the landlord met the requirements of our documentation obligation.

The Auditors stated in the Draft Report that an additional step of reviewing underlying financial data for reasonableness and allowability was also required. As a result, SWK has since additionally reviewed the underlying charges for the four leases in question for reasonableness and allowability and identified charges that did not have prior approval for capital expenditures or were simply missing documentation.

Utilizing this new approach, we agree that CAM Fees of $475,025 should be refunded. Nonetheless, SWK does not believe that any indirect costs should also be impacted. According to the methodology set forth in Appendix A of the Draft Report, the Auditors have reached their questioned cost figures by applying a factor representing associated indirect costs to certain questioned direct costs. We believe this is an error. Allowable indirect costs follow all costs that meet the definition set forth for indirect rate "base" costs *regardless of whether the costs in the base are allowable or unallowable*.

According to 45 CFR § 75.413(e):

> The costs of certain activities are not allowable as charges to Federal awards. However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct costs for purposes of determining indirect cost rates and be allocated their equitable share of the non-Federal entity's indirect costs . . .

More specifically, where the existence of the underlying base cost and the base cost's direct allocability is established, whether the base cost is technically an "allowable" or "unallowable" cost has no impact on calculation or application of an entity's indirect cost rate. This holds for any questioned costs in the Draft Report where there is an asserted indirect cost component.

While SWK agrees that it should refund the aforementioned CAM fees, we disagree with the Auditors' conclusions regarding the other CAM charges in the Draft Report. In our assessment, SWK found that many of the charges were allowable and reasonable. Table 4 summarizes the differences between the Auditors' and SWK's assessments of the CAM charges, and Appendix 2 provides support for SWK perspectives summarized in Table 4. In addition, SWK has detailed work papers we can make available upon request.

Table 4 - Summary of Questioned CAM Charges

	Per Auditors			Per SWK
Facility	**Questioned CAM Fees**	**Plus Indirect**	**Total**	**Agreed-To Questioned Amount**
Facility 1	1,472,878	212,094	1,684,973	383,727
Facility 2	13,644	1,965	15,609	13,644
Facility 3	362,000	52,128	414,128	10,985
Facility 4	494,000	71,136	565,136	66,669
Total	**$2,342,522**	**$337,323**	**$2,679,846**	**$475,025**
				Amount Due

Action Plan

SWK will refund the federal government for overpayments of CAM fees during the relevant period in the amount of $475,025 as summarized in Table 4. Additionally, SWK has changed its current annual CAM review process to a quarterly review to reconcile CAM fees and regularly inspect underlying transactional data to ensure adequate documentation and reasonableness.

Also, SWK has met with the relevant landlords related to CAM lease agreements to reemphasize the nature of allowable CAM charges. Through the quarterly review process CAM charges determined to be unallowable, unreasonable, or unnecessary will continue to be reimbursed by the landlord and credited to the corresponding grants in the corresponding period to avoid charging SWK's federal awards.

Questioned Costs for Leases –
One-Time Lease Payments

The Auditors questioned certain one-time payments that SWK made that were required by three lease contracts for UAC facilities. These payments were incurred in the first year of newly rented facilities during 2016 and were characterized in the respective lease agreements as "additional rent." The Auditors have stated that the lease agreements did not specify the purpose or use of the additional rent. In the Draft Report, the Auditors state that SWK staff stated that the payments corresponded to landlord-incurred expenses to renovate the facilities to make them operational for UAC shelter purposes.

For all three leases, these expenses were related to making the facilities ready for UAC shelter program purposes, namely serving as high quality living spaces for children, compliant with robust federal, state, and local requirements.

Acquiring suitable facilities within the parameters of the UAC shelter program is a particular challenge, and one about which we believe ORR is well aware. As recognized in the introduction to the draft report, the UAC shelter program faces the significant challenge of operating under unknowable and rapidly changing conditions under which closures and operational contractions are tied to tenuous political and economic conditions. As a matter of programmatic design, the federal government delegates these challenges to SWK and similar organizations across the country while funding UAC operations only incrementally with, for understandable federal appropriations law reasons, explicit statements that funds are only available on a year-to-year basis with absolutely no guarantee of continued funding (or operations at a particular location) in future years. Exacerbating the challenge – again for good reason – UAC shelter program requirements for facilities are robust, as are state and local standards for facilities that provide a living space for children, making it difficult, if not impossible, to find turn-key facilities that are suitable to this purpose.

In this environment, SWK is asked to locate landlords who will provide facilities on a year-to-year, cancelable term. As a general matter, landlords will not subsidize the preparation of a facility to UAC shelter program standards and will require the prospective tenant to take on liability for the related costs. It is not unusual for commercial landlords to designate additional expenses such as "additional rent" as treatment, as additional rent may offer the landlords additional protection in disputes with tenants and in the event of a tenant's bankruptcy.

SWK and other similarly situated UAC shelter providers have no choice but to obtain, often on short notice, facilities that meet federal, state, and local standards, and must ensure they have the right to cancel the lease upon cessation of UAC shelter

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6002 Jain Lane, Austin, Texas 78721
phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

program funding. So long as the funding of this program continues to be annual, SWK and other providers will be negotiating with commercial landlords in the context of cancellation after one year. The *only* commercially available ways to meet all federal requirements is to include the costs of making a facility ready in the

Table 5 - Rent analysis
Facility F

Analysis of Reasonableness of Rent

Incremental Borrowing Rate	6%
Potential Occupancy Period	10

Year	Lease Payment	Discounted Lease Payment
1	1,512,500*	$1,426,887
2	1,140,000	$1,014,596
3	1,162,800	$976,309
4	1,186,056	$939,467
5	1,209,777	$904,016
6	1,233,973	$869,902
7	1,258,652	$837,076
8	1,283,825	$805,488
9	1,309,502	$775,092
10	1,335,692	$745,843
	Total	$9,294,676
		vs
	Fair Value of Asset (Appraisal)	$14,860,000

*Even with additional rent in year one payments are reasonable given value of facility.

rent of the facility, whether through higher first year rent or through a provision for an additional rent with the cancellation liability. Within this framework, SWK is careful to ensure that rental rates are reasonable. We further note that 45 CFR 75.465 recognizes *"rental costs are allowable to the extent that the rates are reasonable"*. It allows for the structuring of leases in a commercially consistent manner. As described above, SWK's approach to leasing these facilities was prudent under the circumstances, including with respect to how SWK managed its UAC program funds. As shown in Table 5, SWK rental rates were reasonable.

Action Plan

SWK will continue to ensure lease payments are within the foundation of the threefold classification analysis described earlier under the capital lease response. Further, we will continue to ensure that related rental costs, as discussed herein, are within the limits of reasonableness as highlighted in Table 5 but will remove the practice of stipulating "additional rents" in future leases.

Questioned Compensation – Year-End Influx Bonus

SWK made extra compensation payments in the form of influx bonuses to certain employees at UAC shelters during 2016. The Auditors questioned these bonuses in the Draft Report, stating that SWK could not provide documentation that the bonus recipients were involved in expanding bed capacity.

SWK believes the tables and narrative below support our conclusions that the Influx Bonuses were reasonable and necessary. Not only were they based on past influx bonus policies but also followed similar bonus policies applied previously to incentivize employees during demanding periods. In line with the policy, the influx bonuses constituted an important mechanism to reward and retain SWK staff for long hours imposed by the influx that occurred during this 2015-2016 period.

As the Auditors noted in the Draft Report, SWK's 2016 Unaccompanied Minor Operations Manual (the "Manual") included the influx bonus policy as it had been historically applied. Section 3.04 of the Manual states:

> SWK recognizes that during the influx season staff are called upon to go above and beyond to help expand bed capacity for the company…
>
> Employees are eligible for this bonus if they fall into one of the three (3) categories below:
>
> 1. Volunteers at home. Employees who volunteer to work extra hours in the "home program" to cover for the employees that are out in the field assisting a start-up program. This bonus compensation is offered as an incentive for helping maintain smooth operations back in the home program.

2. Assist in expansion. Employees who assist in expanding beds in their current programs by working extra hours on efforts such as working job fairs, preparing building for increased capacity, coordinating purchases, etc.

3. Assist in program launch. Employees who assist in launching a new program in their region by working extra hours on efforts such as working job fairs, preparing building for increased capacity, coordinating purchases, etc.

SWK provided the influx bonuses at issue pursuant to this policy. Additionally, four extraordinary conditions existed during the influx period that support SWK's decision to pay bonuses to employees impacted by the influx: (1) the employees in the UAC shelters referenced in the Draft Report worked unusually long hours due to the influx, as demonstrated by timesheets and payroll records; (2) SWK's bed capacity expanded by a remarkable 46% in response to the influx; (3) the number of UAC clients increased significantly during the influx; and (4) high employee turnover during the influx exacerbated work requirements for the remaining employees. Each of these conditions are further explored below.

Table 6 illustrates the additional hours worked by employees in the programs that were impacted by the influx. It shows that the influx-bonus recipients registered an average 8% more working hours (exclusive of holiday, paid time off, sick, and other hours) in fiscal year 2016 over the previous year. As the table points out, the timing of the influx bonus was tied to the long hours worked during the influx, which are substantiated by employee timesheets. SWK felt compelled to reward its team with influx bonuses, as the Operations Manual provided for, during an unusual period in which many employees stepped up their commitment to the services we provided for the youth in our care.

It is worth noting that all the staff in Table 6 were salaried, except for the Shift Leaders. SWK concluded that the whole team – salaried and hourly – deserved financial recognition and especially wanted to recognize the Shift Leaders who had demonstrated exemplary leadership and commitment during the influx.

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phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

Table 6 - Influx Bonus Recipients Hours Worked - 2015 vs 2016 - by position

Influx Bonus Date >

Job Title	Influx Bonus Recipients	Average Hours Worked per FTE FY14-15	Average Hours Worked per FTE FY15-16	% Increase in Hours Worked
Assistant Lead Case Manager	17	1,810	2,036	12%
Assistant Lead Clinician	4	2,076	2,114	2%
Assistant Lead Med Coordinator	4	1,720	2,064	20%
Assistant Program Director	27	2,126	2,223	5%
Executive Assistant	23	1,871	2,094	12%
Head Cook	17	1,967	2,069	5%
Lead Case Manager	22	1,948	2,083	7%
Lead Clinician	12	1,888	2,046	8%
Lead Medical Coordinator	6	2,076	2,082	0%
Lead Teacher	13	1,937	2,048	6%
Lead Trainer	6	2,041	2,124	4%
Maintenance Specialist	3	1,941	1,993	3%
Maintenance Worker	2	1,885	2,161	15%
Program Director	22	2,185	2,265	4%
Shift Leader	115	1,772	1,950	10%
Shift Supervisor	38	2,044	2,206	8%
Average Hours Worked per FTE	**331***	**1,917**	**2,074**	**8%**

Average work year assumes 2,080 hrs minus 80 hrs Holiday and 80 hrs PTO = 1,920 hrs worked

Average increase in hours worked year over year

*Of 358 total Influx Bonus Recipients only 331 were employed throughout both periods being compared.

As Table 7 demonstrates, in addition to its employees working more hours, SWK expanded bed capacity during the influx period. From September 2015 to September 2016, SWK's beds increased from 2,283 to 3,343, a 46% increase. The red line indicates the timing of the influx bonus, relating the timing of the bonus payments to an increase in the bed count (and again in the client count in Table 8).

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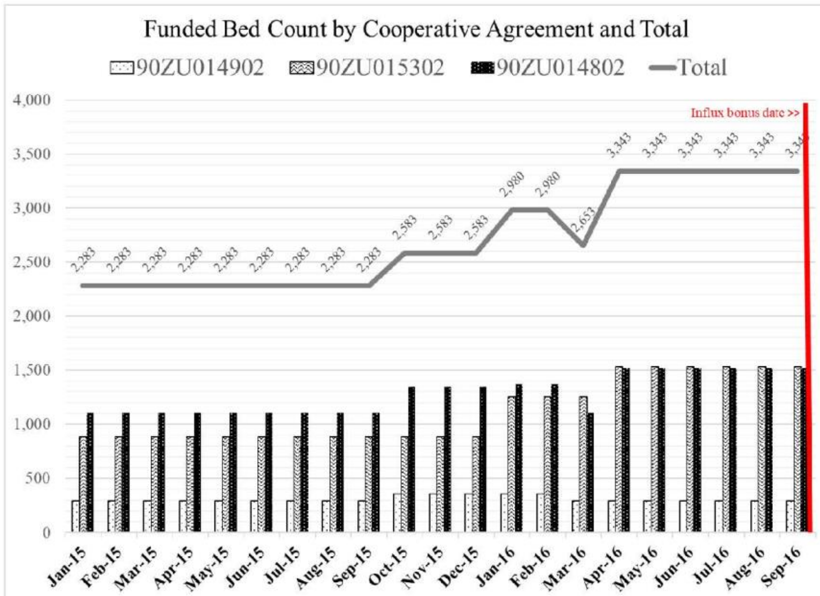
Table 7 – Funded Bed Count during 2015-2016



In further exacerbation of the influx-period environment, the number of UAC clients served also increased significantly, as illustrated in Table 8. During the entirety of 2015, SWK experienced a large increase in UAC clients, followed by a drop in early 2016 and then again by a dramatic rise in mid-2016.

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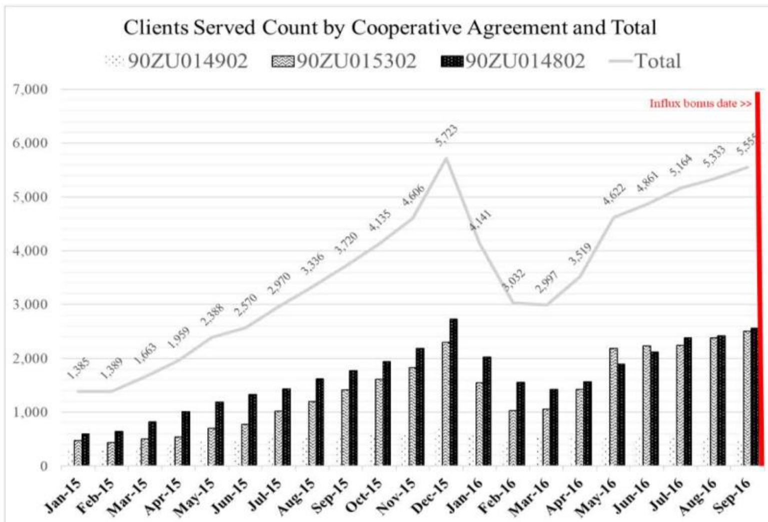
Table 8 – Clients Served During 2015-2016



The conditions illustrated in Tables 7 and 8 – rapid increases, decreases, and then increases in beds and clients served – added stress to an already stressed environment. And because of the up-and-down nature of the influx, staff resignations grew dramatically over the same period, as Table 9 depicts. This compounded the issues presented by the influx and required the remaining staff to work more than they otherwise would have.

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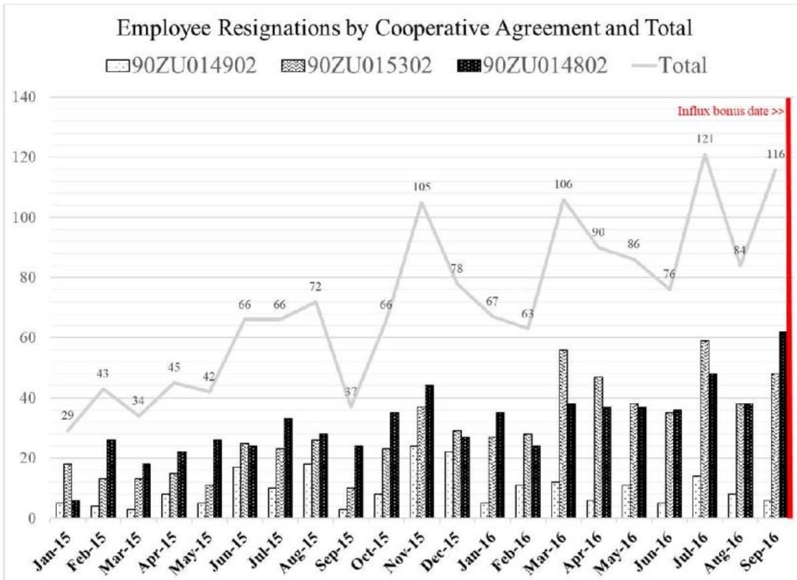
Table 9 – Employee Resignations during 2015-2016



Conclusion

The influx was indeed historical, and SWK made a management decision to compensate our employees accordingly pursuant to the terms of the influx bonus policy in SWK's Operations Manual. SWK asserts that the bonuses were reasonable and appropriate under the unique conditions and were in line with employees' expectations given past practices.

Action Plan

SWK will continue to review and update as needed its bonus policies to ensure they are reasonable and necessary and applied consistently across the organization. In addition, the timesheet system upgrade discussed further below will help to further manage and enhance timekeeping.

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Questioned Compensation –
Executive Compensation above Executive Level II Limit

The Auditors questioned the allowability of certain executive salaries because they exceeded the Executive Level II salary limit for FY2016.

SWK operated under a predetermined cost rate agreement during the relevant period that entitled it to indirect costs calculated at 14.4% of base direct costs. The executive salaries in question were charged to UAC awards indirectly through application of this predetermined rate.

SWK sought independent legal counsel from Feldesman Tucker Leifer Fidell LLP, a law firm in Washington, D.C. with extensive experience in federal grant management. In an October 12, 2018 letter to the Office of Audit Services, Feldesman Tucker referenced 45 C.F.R. Part 75, Appx. IV § C.1.e and stated in part:

> [A] predetermined rate means an indirect cost rate, applicable to a specified current or future period. . . . The rate is not subject to [after-the-fact] adjustment. . . . based on the organization's actual costs. . . . Second, the salary cap [cited by the Auditor's Draft Report] simply does not apply to indirectly charged salaries.

The Auditors claim that six individuals were improperly paid in excess of the HHS Executive Level II salary cap. The Auditors shared the names of these individuals and we have confirmed that all are personnel whose salary SWK paid with funds recovered under SWK's indirect cost rate agreement.

As such, we disagree with the Auditors questioning of the costs related to these payments. Costs funded through amounts recovered under SWK's predetermined indirect cost rate agreement are not required to be expended in accordance with federal "allowable cost" restrictions, whether under the cost principles or through appropriations-rider-based limitations such as the Executive Level II salary cap. We believe we had adequately demonstrated the source of funds used for these compensation amounts to the Auditors and are happy to provide additional documentation demonstrating that if necessary.

As mentioned in the "Other Matters" section of the Draft Report, in September 2019, SWK moved to a provisional-final indirect rate approach. Accordingly, SWK now annually submits recent actual cost data to Health and Human Service's Cost Allocation Services (CAS) to establish (1) a prospective provisional rate for the upcoming year(s), and (2) a final rate for the period recently concluded. We will continue to coordinate closely with CAS regarding allowability of indirectly charged costs.

In addition, SWK undertook a third-party assessment of compensation by a nationally recognized expert in the field of compensation, Wipfli LLP. Wipfli conducted a market study of compensation rates, attached as Appendix 3 that supports the compensation rates for SWK executives for the 2016 period.

Conclusion

A predetermined rate is not subject to after-the-fact adjustments and the Draft Report's cited salary caps do not apply to indirect salaries. In order to vie for talent in our market, SWK competes not only with local not-for-profits but also against for-profit companies on a national scale. Our market-based compensation plans supported by independent third-party analysis reflect an appropriate level of compensation.

Action Plan

SWK will continue to undertake annual compensation studies for its executives to maintain transparency. Additionally, we have and will continue to use Wipfli and other independent third parties, such as Aon PLC and Arthur J. Gallagher & Co., to conduct market compensation studies for all our staff on a periodic basis.

Questioned Compensation –
Bonus Policy Could Allow for Unreasonable Bonuses

In the Draft Report, the Auditors commented that there was potential vulnerability in SWK's bonus policy because it did not limit possible bonuses to a set percentage. We have a flexible, discretionary bonus policy and an established continuing Compensation Committee that directs compensation and bonus strategies on an annual basis. Although the bonus policy itself is silent on a set percentage, SWK has empowered its Compensation Committee to declare and enforce all the particulars of these strategies, including setting a fair-market-based bonus ceiling over the past 2 years at 15% per annum for employees, that is subject to change based on market studies. SWK cannot include that specificity in its public bonus policy because it would have the effect of setting bonus expectations in the employee base and limit our flexibility with respect to making bonus/compensation decisions that reflected the current business conditions. As a result, SWK uses the Compensation Committee to declare when and if a bonus will be awarded based on the availability of funds, among other criteria.

Further, SWK used and continues to use Aon and Wipfli, two independent third parties, to confirm the fair-market percentage for our bonus structure. Because we do not typically raise employee compensation levels annually, a market-driven bonus policy helps to keep us competitive with our peers in recruiting and retaining talent.

**Other Questioned Costs -
Other**

The Auditors identified other questioned costs involving employee payroll, fringe benefits, contractor payments, and personal items for UAC clients. The total amount of these charges was $139,843.

SWK has comprehensively reviewed the supporting documentation for each of the expenses in Table 10 and identified the amounts that are properly substantiated.

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Table 10 - Summary of Other Questioned Costs

Sample #	Reason	Per Auditors Questioned Amount	Per SWK Questioned Amount
88	Inadequate documentation supporting workers compensation rate	$16,968	$0
103	Inadequate documentation for employee medical expense	42,141	-
109	Incorrect Pay Rate	(294)	(165)
112	No documentation provided for certain employees	7,581	-
120	Inadequate documentation supporting workers compensation rate	57,081	-
148	Discrepancy between timecard and earnings statement	359	359
1139	Inadequate documentation for salary allocation from one program to another	5,000	5,000
1142	Duplicate payment and incorrect pay rate	796	796
1151	Discrepancy between timecard and earnings statement, incorrect pay rate	203	203
1124	Inadequate documentation for personal care items (packing slips missing)	853	853
1146	Contract labor outside of performance period	9,155	9,155
	Total	**$139,843**	**$16,201**

For expenses in Sample #88 and #120, the Auditors state there is inadequate support for the workers compensation (WC) rate applied to salary charges. SWK has thorough support of the WC rate applied to each of its programs for this period. The WC rates are based on several factors including payroll, job hazards, WC class codes, and loss history. At times these vary by program.

Per 45 CFR § 75.447(d)(4):

> [I]f individual departments or agencies of the non-Federal entity experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations.

SWK, with the help of its third-party plan broker and administrator, Marsh Wortham (Marsh), applied an allocation methodology to the programs in question, resulting in the rates used. SWK can provide the methodology from Marsh upon request.

For the expenses in Sample #103, the Auditors indicate that they did not receive earnings statements showing the health insurance plan premium charges for several employees. SWK has earnings statements and enrollment documents verifying the health insurance charges and can make them available upon request.

For the expenses in Sample #109, the Auditors have pointed out an underpayment of 18.32 hours. SWK has backup that the underpayment was in fact paid for 10.32 hours.

For the expenses in Sample #112, the Auditors have alleged no documentation in support of several salary charges. SWK has backup for the hours worked and earnings statements and can make them available upon request.

For the expenses in Samples #148, #1139, #1142, #1151, #1124, and #1146, SWK has reviewed the underlying documentation and does not contest the Draft Report's questioned costs.

Action Plan

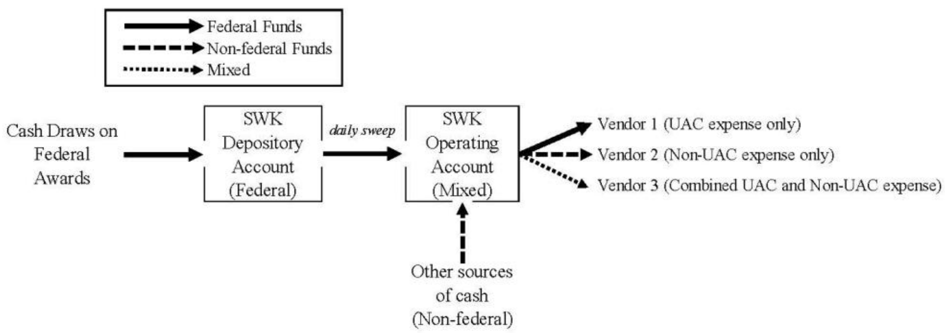
SWK has undertaken several new procedures to address findings in the Other Questioned Costs section of the Draft Report, including more timely and proactive review of timesheets by payroll staff to identify and communicate timesheet anomalies to relevant individuals, increased monitoring of worker and supervisor timesheet approval, and increased emphasis on cutoff testing at year-end for the non-payroll findings.

Additionally, SWK has begun implementation of Kronos Dimensions, a new automated HRIS system that will replace the existing paper-based Aloha system. As a result, first quarter 2021, SWK will no longer have the need for the Aloha reports currently used for reporting employee salary, title, and department changes. In addition, the Dimensions implementation will also include new timekeeping, scheduling, and integrated payroll subsystems. These new subsystems should reduce the errors caused by the prior paper-based processes, as highlighted in Table 10 above.

Lacked Effective Control and Accountability of Federal Funds – Did Not Adequately Safeguard Federal Funds

In the Draft Report, the Auditors stated they were unable to trace funds through SWK's bank flows to ensure federal funds were used "solely and completely for the UAC Program." As the Auditors noted, federal funds drawn on UAC Programs are originally deposited into a segregated depository account and then swept daily into SWK's master operating account, where they are mixed with funds from non-federal sources. SWK documents the timing, amount, and nature of the funds transferred (federal vs. non-federal). SWK's operating account is then used to make all the disbursements necessary for operation of its various federal and non-federal programs. Below is a simplified illustration of the flow of funds:

SWK Federal Funds Flowchart



Again, SWK can account for and quantify all of funds reflected in the arrows in the flowchart above. SWK's processes effectively trace the flow of funds and ensure that federal funds are used only for federal purposes. The Auditors acknowledge in the Draft Report that "it is not necessary for a grantee to maintain a separate account for Federal funds" but that "the grantee must be able to document that these funds are used for allowable expenses under the award." SWK does just that.

Conclusion

SWK asserts that the ability to trace and quantify each of the flows as discussed above accomplishes this requirement.

Action Plan

As a result of discussions with the Auditors on this issue, SWK financial leadership met to diagram bank flows to make it easier to describe our complex banking operations.

SWK will continue to analyze potential improvements in how it directs funds through its accounting and banking systems. SWK believes that the ability to trace and quantify each of the flows in and out of its accounting system and distinguish them as federal vs non-federal accomplishes the requirement stated by the Auditors.

Lacked Effective Control and Accountability of Federal Funds – Unable to Support Expenses and Indirect Base on Federal Financial Draft Reports

In the Draft Report, the Auditors stated that SWK did not maintain adequate documentation for expenses and the indirect cost base reported on its quarterly Federal Financial Reports (FFRs). SWK was able to provide a summary trial balance report from our accounting system generated for the purpose of compiling and submitting the FFRs at the time they were due. However, the Auditors requested a detailed, rather than summary, report. SWK tried generating a detailed trial balance report that would agree with the summary version and support the FFR amounts, but at times, due to additional entries/adjustments booked after the books were originally closed, the amounts did not match. We recognized this was an issue.

Action Plan

SWK has improved several processes, including the month-end and year-end close process. Additionally, entries to closed periods are no longer allowed without prior management approval. Further, a detailed trial balance report – instead of a summary version – is now also generated and saved at the time the FFRs are compiled in order to satisfy audit requirements. We believe this will address future issues, but we are vigilant and will continue to identify areas for improvement.

Lacked Effective Control and Accountability of Federal Funds – Did Not Record Fixed Assets Timely

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The Auditors noted in the Draft Report that certain fixed assets were not identified and recorded in a timely manner. We understand the concern and agree.

Action Plan

Due to the recent growth of the overall operations, the accounting department has added staff capacity. This affords the department the resources to ensure the proper and timely recording of fixed assets.

SWK's fixed asset team has implemented a process of regularly reviewing all transactions to identify any expenditures that meet or exceed the capitalization threshold of $5,000. On a weekly basis all transactions are examined, and all identified transactions are capitalized. The resulting assets are subsequently entered into the asset management database of SWK's financial management system.

Summary

Over the past 18 months, SWK's leadership team, in partnership with its Board of Directors, embarked on a series of organizational and operational changes to address issues related to decisions made by previous leadership, including: adoption of the 6 Core Strategies, an evidence-based program designed by the National Association of State Mental Health Program Directors (NASMHPD); reorganization of the finance and accounting department; hiring independent third-parties to help

SWK improve its services, policies, processes, and procedures; adopting a new management model; and utilizing digital systems to better track and manage our operations.

SWK is proud of the progress it has made and is committed to its mission of transforming the lives of children, youth, families, and communities by building a sense of hope and opportunity.

SWK appreciates the opportunity to respond and provide our perspectives on the issues identified in the Draft Report. We hope we have an opportunity to meet with you again to discuss any issues for which you may need additional information. We

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very much value your input and thank you for highlighting improvement areas to make SWK better and more responsive in the future.

As we close, SWK has included Table 11 summarizing the questioned costs per the Draft Report as well as the amounts due under SWK's analyses herein. Should the Auditors require additional information, please let us know.

Table 11 - Summary of Questioned Costs

	Per Auditors				Per SWK				
Reason	**Direct**	**Plus Indirect**	**Projection of Sample**	**Total**	**Direct**	**Plus Indirect**	**Projection of Sample***	**Total**	**Amount refunded through ACF Disallowance**
Capital Leases	$3,052,226	$439,520	-	$3,491,746	-	-	-	-	132,693
Related Party Lease	-	-	-	-	-	-	-	-	267,334
CAM	2,342,522	337,323	-	2,679,845	475,025	-	-	475,025	-
One-time Rent	1,001,667	-	-	1,001,667	-	-	-	-	-
Influx Bonuses	3,264,782	470,130	-	3,734,912	-	-	-	-	-
Other Costs	139,843	-	728,406	868,249	16,201	-	84,385	100,586	-
Exec Compensation	-	1,354,429	-	1,354,429	-	-	-	-	-
Total	**$9,801,040**	**$2,601,402**	**$728,406**	**$13,130,848**	**$491,225**	**$0**	**$84,385**	**$575,611**	**$400,027**
								Amount Due	

*Projection of sample of questioned costs by SWK based proportionally on projection of sample by auditors.

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Appendix

Appendix 1 – 90% Test Auditors vs Independent Third-Party for all leases

Table 3 - 90%Test Auditors vs Independent Third Party
Facility A

Auditor Analysis

Incremental Borrowing Rate: 3.25%
Lease Term (Years): 10

Year	Lease Payment	Discounted Lease Payment
1	660,000	$639,225
2	660,000	$619,104
3	660,000	$599,617
4	660,000	$580,743
5	660,000	$562,463
6	660,000	$544,758
7	660,000	$527,611
8	660,000	$511,003
9	660,000	$494,918
10	660,000	$479,340
	Total	$5,558,781

vs

Fair Value (Tax Records): $1,122,457

Greater than 90% = *Capital Lease*>> **495%**

Independent Third-Party Analysis

Incremental Borrowing Rate: 6.00%
Lease Term (Years): 2

Year	Lease Payment	Discounted Lease Payment
1	660,000	$622,642
2	660,000	$587,398
	Total	$1,210,039

vs

Fair Value (Appraisal): $5,500,000

Less than 90% = *Operating Lease*>> **22%**

Table 3 - 90%Test Auditors vs Independent Third Party
Facility C

Auditor Analysis

Incremental Borrowing Rate: 3.25%
Lease Term (Years): 10

Year	Lease Payment	Discounted Lease Payment
1	480,000	$464,891
2	480,000	$450,258
3	480,000	$436,085
4	480,000	$422,358
5	480,000	$409,064
6	480,000	$396,188
7	480,000	$383,717
8	480,000	$371,639
9	480,000	$359,940
10	480,000	$348,611
	Total	$4,042,750

vs

Fair Value (Tax Records): $1,020,356

Greater than 90% = *Capital Lease*>> **396%**

Independent Third-Party Analysis

Incremental Borrowing Rate: 6.00%
Lease Term (Years): 2

Year	Lease Payment	Discounted Lease Payment
1	480,000	$452,830
2	480,000	$427,198
	Total	$880,028

vs

Fair Value (Appraisal): $1,850,000

Less than 90% = *Operating Lease*>> **48%**

Table 3 - 90% Test Auditors vs Independent Third Party
Facility D

Auditor Analysis

Incremental Borrowing Rate: 3.25%
Lease Term (Years): 10

Year	Lease Payment	Discounted Lease Payment
1	$600,000	$581,114
2	$600,000	$562,822
3	$600,000	$545,106
4	$600,000	$527,948
5	$600,000	$511,330
6	$600,000	$495,234
7	$600,000	$479,646
8	$600,000	$464,548
9	$600,000	$449,926
10	$600,000	$435,763
	Total	$5,053,437

vs

Fair Value (Tax Records): $481,966

Greater than 90% = *Capital Lease* >> 1049%

Independent Third-Party Analysis

Incremental Borrowing Rate: 6.00%
Lease Term (Years): 2

Year	Lease Payment	Discounted Lease Payment
1	600,000	$566,038
2	600,000	$533,998
	Total	$1,100,036

vs

Fair Value (Appraisal): $4,300,000

Less than 90% = *Operating Lease* >> 26%

Table 3 - 90% Test Auditors vs Independent Third Party
Facility E

Auditor Analysis

Incremental Borrowing Rate: 3.50%
Lease Term (Years): 10

Year	Lease Payment	Discounted Lease Payment
1	2,105,000	$2,033,816
2	1,560,000	$1,456,277
3	1,591,200	$1,435,171
4	1,623,024	$1,414,372
5	1,655,484	$1,393,874
6	1,688,594	$1,373,672
7	1,722,366	$1,353,764
8	1,756,813	$1,334,144
9	1,791,950	$1,314,809
10	1,827,789	$1,295,754
	Total	$14,405,653

vs

Fair Value (Tax Records): $3,940,075

Greater than 90% = *Capital Lease* >> 366%

Independent Third-Party Analysis

Incremental Borrowing Rate: 6.00%
Lease Term (Years): 2

Year	Lease Payment	Discounted Lease Payment
1	2,105,000	$1,985,849
2	1,560,000	$1,388,394
	Total	$3,374,244

vs

Fair Value (Appraisal): $13,655,000

Less than 90% = *Operating Lease* >> 25%

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Appendix 2 – Review of CAM Fees - Summary of Questioned Charges

Table 13 - Questioned CAM Fees by Month by Facility

		Per Auditors	Per SWK	
Facility	**Date**	**Questioned Amount**	**Allowable Amount**	**Agreed-To Questioned Amount**
Facility 1	10/6/2015	$145,335	$113,135	$32,200
	11/9/2015	$145,335	$113,135	$32,200
	12/9/2015	$145,335	$113,135	$32,200
	1/9/2016	$145,335	$104,009	$41,326
	2/9/2016	$145,335	$104,009	$41,326
	3/2/2016	$145,335	$104,009	$41,326
	4/2/2016	-$186,337	-$186,337	$0
	4/2/2016	$131,200	$104,009	$27,191
	5/2/2016	$131,200	$104,009	$27,191
	6/2/2016	$131,200	$104,009	$27,191
	7/2/2016	$131,200	$104,009	$27,191
	8/2/2016	$131,200	$104,009	$27,191
	9/2/2016	$131,200	$104,009	$27,191
	Total	$1,472,878	$1,089,152	$383,727
Facility 2	10/1/2015	$1,137	$0	$1,137
	11/1/2015	$1,137	$0	$1,137
	12/1/2015	$1,137	$0	$1,137
	1/1/2016	$1,137	$0	$1,137
	2/1/2016	$1,137	$0	$1,137
	3/1/2016	$1,137	$0	$1,137
	4/1/2016	$1,137	$0	$1,137
	5/1/2016	$1,137	$0	$1,137
	6/1/2016	$1,137	$0	$1,137
	7/1/2016	$1,137	$0	$1,137
	8/1/2016	$1,137	$0	$1,137
	9/1/2016	$1,137	$0	$1,137
	Total	$13,644	$0	$13,644
Facility 3	6/30/2016	$68,000	$87,754	-$19,754
	7/6/2016	$98,000	$87,754	$10,246
	8/2/2016	$98,000	$87,754	$10,246
	9/2/2016	$98,000	$87,754	$10,246
	Total	$362,000	$351,015	$10,985
Facility 4	5/20/2016*	$190,000	$164,358	$25,642
	6/30/2016	$76,000	$65,743	$10,257
	7/6/2016	$76,000	$65,743	$10,257
	8/2/2016	$76,000	$65,743	$10,257
	9/2/2016	$76,000	$65,743	$10,257
	Total	$494,000	$427,331	$66,669
	Grand Total	**$2,342,522**	**$1,867,498**	**$475,025**

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Table 15 - SWK Questioned Costs Facility 4

General Ledger (Accrual)
Facility 4 - 1-10 - (28)
Months: March 2016 - Dec 2016

Proper	Date	Period	Description	Control	Refer	Debit	Credit	Net	Remarks	Page #	Service Period	Disallowed Comment
28	5/26/2016	16-May	* [redacted]	P-179	5456	3,501.16			[redacted] computer equipment	108		Computer for [redacted]
28	7/27/2016	16-Jul	[redacted]	P-413	16033100	14,582.30			#1603310007 - July electri	51	*6/20- 7/20*	*Excess Amount*
28	11/5/2016	16-Nov	[redacted]	P-974	13288	6,550.00			Raise/void fill interior	34		No PO approval
28	4/4/2016	16-Apr	[redacted]	P-Odon	8386-0416	8,025.45			[redacted] Kitchen bulbs/repairs	144		No PO approval
28	3/28/2016	16-Mar	[redacted]	P-4	Filtrati	134.06			[redacted] Filtration	40, 111		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-4	Filtrati	134.06			[redacted] Filtration	40, 111		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-4	Filtrati	1,490.94			[redacted] Filtration	40, 111		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-4	Filtrati	134.06			[redacted] Filtration	40, 111		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-4	Filtrati	1,625.00			[redacted] Filtration	40, 111		Incorrect Amount/Missing Documentation
28	5/1/2016	16-May	[redacted]	P-150	9933-694	15,826.15			[redacted] chiller repairs, r	46		No PO approval
28	5/12/2016	16-May	[redacted]	P-7	ClosedL	2,125.00			[redacted] Closed loop chemical	110		Incorrect Amount/Missing Documentation
28	5/12/2016	16-May	[redacted]	P-7	ClosedL	175.32			[redacted] Closed loop chemical	110		Incorrect Amount/Missing Documentation
28	8/10/2016	16-Aug	[redacted]	P-516	23850	6,917.18			[redacted] Chiller #2 refrige	157		No PO approval
28	8/26/2016	16-Aug	[redacted]	P-587	24097	6,350.17			[redacted] Repl fire damper a	85	8/16/2016	No PO approval
28	8/26/2016	16-Aug	[redacted]	P-588	24098	5,664.23			[redacted] Repl fier damper &	87	8/17/2016	No PO approval
28	10/24/2016	16-Nov	[redacted]	P-856	24733	5,688.54			[redacted] 2nd Fl #4 - chg ou	69		No PO approval
28	10/27/2016	16-Nov	[redacted]	P-866	24878	7,468.17			[redacted] Replace 6 steam v"	67		No PO approval
28	12/31/2016	16-Dec	[redacted]	P-906	241-6947	12,968.35			Leak chiller #2 replace gasket	71	*Aug-16*	No PO approval
28	8/22/2016	16-Nov	[redacted]	P-906	241-6947	12,968.35			[redacted] Disassemble Chille			No PO approval
28	8/4/2016	16-Aug	[redacted]	P-506	23749	16,785.66	302.33		[redacted] Add 300 Refrigeran			No PO approval
28	11/2/2016	19-Nov	[redacted]	P-846	16-681Y	4,349.52			[redacted] Shower renovations	107	10/31/2016	No PO approval
28	8/31/2016	19-Aug	[redacted]	P-550	16-681Y	20,313.34			[redacted] Shower renovations	106	8/25/2016	No PO approval
28	8/31/2016	16-Aug	[redacted]	P-400	PAP1	14,463.05			[redacted] Shower renovations	122	7/31/2016	No PO approval
28	7/28/2016	16-Aug	[redacted]	P-508	8347770	4,058.30			[redacted] Repairs to roof	102	7/28/2016	Roofing Repairs
28	6/30/2016	16-Jul	[redacted]	P-386	8347554	3,534.37			[redacted] repairs to roof	103	6/30/2016	Roofing Repairs
28	3/28/2016	16-Mar	[redacted]	P-7	Closed L	175.32			[redacted] Closed lo	110		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-7	Closed L	175.32			[redacted] Closed lo	110		Incorrect Amount/Missing Documentation
28	3/28/2016	16-Mar	[redacted]	P-7	Closed L	1,949.68			[redacted] Closed lo	110		Incorrect Amount/Missing Documentation
28	3/31/2016	16-Mar	Property insurance	J-11	2016 Ins	36,589.71			Property Ins	121		Excess Amount

Reason for Disallowance		Amount
No PO approval		144,338.16
Computer for [redacted]		3,501.16
Roofing Repairs		7,592.67
Billed by mistake		-
Incorrect Amount/Missing Documentation		8,118.76
Excess Amount	∑As	2,619.47
Total Disallowed		166,170.22

AmeriPower Invoice 16033100 Excess: 288.25 A1

Property Insurance			
Location	Amount Charged	Excess-Disallowed	
[redacted]	36,589.71	2,236.34	A2
[redacted]	34,985.45	632.07	
Total Charged	71,575.16	2,868.41	
Amount per Invoice	68,706.75		
Estimated amount @ 50%	34,353.38		
Invoice 43278462 Excess: $		94.88	A3

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***Office of Inspector General Note:** We redacted text containing sensitive information.

southwest key programs

National Headquarters
6002 Jain Lane, Austin, Texas 78721

phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

Appendix 3 – Executive Compensation – Third-Party Market Analysis

WIPFLi
CPAs and Consultants

Southwest Key Programs, Inc.
Base, Annual Incentive, and Total Cash Compensation Estimate for 2016

Revenue: $268,000,000 **18.53% increase from 2013**
Employees: 4646

Job Title	50th %ile Base Midpoint	75th %ile Base Midpoint	90th %ile Base Midpoint	Average Incentive % of Base	50th %ile Total Cash Comp (Base plus Incentive)	75th %ile Total Cash Comp (Base plus Incentive)	90th %ile Total Cash Comp (Base plus Incentive)
Chief Executive Officer	$554,249	$717,167	$822,458	55%	$797,235	$1,331,868	$1,443,473
Chief Financial Officer	$324,635	$413,521	$474,363	46%	$472,839	$602,303	$690,922
Vice President of Human Resources	$261,325	$322,766	$371,069	24%	$323,653	$399,747	$459,571
Chief Operating Officer	$222,323	$279,584	$327,113	42%	$316,261	$397,716	$465,328
General Counsel	$249,321	$284,962	$335,619	17%	$291,253	$332,888	$392,064
Vice President of Immigrant Children Services	$214,058	$255,918	$260,965	35%	$289,247	$345,810	$352,629
Vice President of Community Engagement	$198,469	$223,913	$248,086	22%	$241,954	$272,972	$302,441
Vice President of Communications	$175,739	$216,466	$264,606	24%	$223,877	$279,846	$321,823
Vice President of Youth Justice Services	$155,427	$195,060	$228,220	28%	$198,946	$249,676	$292,121
Vice President of Education Services	$139,493	$159,872	$187,050	16%	$161,735	$185,363	$216,875
Human Resources Director	$117,524	$135,856	$180,617	13%	$133,094	$153,854	$204,546
Communications Director	$128,225	$147,456	$191,000	16%	$136,838	$171,556	$203,901

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southwest key programs

National Headquarters
6002 Jain Lane, Austin, Texas 78721
phone: 512.462.2181 • fax: 512.462.2028 • www.swkey.org

Appendix 4 – Other Questioned Costs – Documentation Detail

Table 14 - Other Questioned Costs - Documentation

For the samples listed below, the Auditors provided a brief explanation for the reason for questioning along with questioned amount totaling $139,843.20 ($129,835.37 + 10,007.83). SWK has included to the right is the documentation available upon request.

Per Auditors					SWK	
Sample #	Sample Amount	Reason	Notes	Questioned Amount	Documentation available upon request	Questioned Amount
88	$16,968.48	Inadequate documentation provided to the support the workers compensation rate of 5% charged to Program 961.	WC Expense based on wages of $339,369.59 for Program 906100 at 5% rate. Check date range is 8/2/16-8/16/2016. SWK provided the following worksheets: WC Exp081616, Wages by Dept, and Rate WC.	$16,968.48	Workers Comp cost allocation plan by program for the relevant period. Correspondence from third party plan administrator providing WC class codes used in allocation.	$0.00
103	$42,140.50	Inadequate documentation provided to the support the amount of Medical expenses paid for these employees: * [redacted]	Requested documention: direct deposit earinings and leave statement for the employees mentioned.	$42,140.50	2015 - 2016 Plan Enrollment documents for all five employees showing Medical Plan enrollment and employer premium amounts. Earnings statements for all five employees showing employer premium benefit paid.	$0.00
109	$48,791.72	Incorrect rate of pay (underpaid). Employee [redacted] was entitled to holiday and administrative leave pay based on pay period reviewed, 12/24/2015 - 1/8/2016.		($294.08)	Earnings statement for subsequent pay period 1/9/2016 - 1/23/2016 showing catch up of 8 hrs of Holiday. Leaves 10.32 hrs remaining unpaid.	($165.12)
112	50,829.19	No documentation provided for claimed expenditure for the following employees selected for review: [redacted]	Only $7,581.13 of the $50,829.19 transaction amount was reviewed.	$7,581.13	Earnings statements and timesheets for relevant period for all six employees.	$0.00
120	$57,081.35	Inadequate documentation provided to support the workers compensation rate of 32% charged to Program 951. Transaction consists of 134 employees.		$57,081.35	Workers Comp cost allocation plan by program for the relevant period. Correspondence from third party plan administrator providing WC class codes used in allocation.	$0.00
148	$192,264.73	Timecard did not support earnings statement for the following employees: [redacted].	Only $28,531.54 of the $192,264.73 transaction amount was reviewed.	$358.53	N/A	$358.53
1139	$4,999.99	No documentation provided to support the expense for [redacted] alloc fr 902900		$4,999.99	N/A	$4,999.99
1142	$6,455.29	Two employees overpaid: 1) employees oaid twice [redacted]) and 2) incorrect rate of pay (overpaid [redacted])		$796.18	N/A	$796.18
1151	$30,175.85	Two employees paid incorrectly: 1) Timecard did not support employee's earnings statement ([redacted] and 2) Incorrect rate of pay (underpaid) [redacted]).		$203.29	N/A	$203.29
1124	$1,177.58	Packing slip do not support invoice for personal care items		$853.02	N/A	$853.02
1146	$10,305.84	Contract labor outside of award period		$9,154.81	N/A	$9,154.81
				$139,843.20		$16,200.70

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***Office of Inspector General Note:** We redacted text containing sensitive information.

APPENDIX G: ACF COMMENTS

ADMINISTRATION FOR
CHILDREN & FAMILIES

Office of the Assistant Secretary | 330 C Street, S.W., Suite 4034
Washington, D.C. 20201 | www.acf.hhs.gov

May 18, 2020

Ms. Christi A. Grimm
Principal Deputy Inspector General
U.S. Department of Health and Human Services
200 Independence Avenue, SW.
Washington, DC 20201

Dear Ms. Grimm:

The Administration for Children and Families (ACF) appreciates the opportunity to respond to the Office of Inspector General (OIG) draft report titled, *Southwest Key Programs Failed To Protect Federal Funds Intended for the Care and Placement of Unaccompanied Alien Children, A-06- 17-07004.*

The following are ACF's responses to the OIG's six recommendations to the ACF Office of Refugee Resettlement:

Recommendation 1:
Review Southwest Key's remaining Unaccompanied Alien Children (UAC) facility leases to determine whether they qualify as capital leases and recover any unallowable costs.

Response:
ACF generally concurs with the OIG's recommendation. ACF is performing on-going financial oversight of Southwest Key's grant management. As briefly noted in the OIG's report footnote #12, one area of focus reviewed by ACF prior to the completion of the OIG audit was related-party leases, which resulted in ACF identifying three related-party leases and issuing a monetary disallowance action against Southwest Key dated July 2, 2019. Southwest Key stated in their response to the disallowance that while they did not agree with the designation of those leases as related-parties, they would not appeal the disallowance action taken by ACF and agreed to reimburse the federal government in full.

Additional components of ACF's review are still in process and were put on a temporary hold due to the imminent release of the OIG's audit. ACF will take into consideration the work performed and the recommendations made by the OIG to determine a final resolution of Southwest Key's grant management performance.

Recommendation 2:
Review the capital leases identified in our audit to determine the amount of unallowable costs associated with the leases since their inception and after our review and recover any unallowable costs.

Response:
ACF generally concurs with the OIG's recommendation. ACF will review the leases identified by the OIG as capital leases, the OIG's calculation of fair market value driving the capital lease determination, and all allowable and unallowable costs attributed to these leases. If ACF determines that Southwest Key incorrectly charged these leases as operating leases and qualify as capital leases, ACF will enforce remedies for noncompliance available as outlined in 45 CFR § 75.371.

Recommendation 3:
Review UAC facility leases since their inception and after our review to ensure the leases meet Federal requirements and include only allowable costs and recover any unallowable costs.

Response:
ACF generally concurs with the OIG's recommendation. ACF is monitoring Southwest Key and will take into consideration the work performed and the recommendations made by the OIG to determine a final resolution of Southwest Key's grant management performance in regards to the allowability of costs over leases.

Recommendation 4:
Provide guidance to Southwest Key related to allowable renovation costs and when prior approval for renovations is required.

Response:
ACF generally concurs with the OIG's recommendation. ACF is monitoring Southwest Key and will take into consideration the work performed and the recommendations made by the OIG to determine a final resolution of Southwest Key's grant management performance in regards to the allowability of costs over renovations.

Recommendation 5:
Ensure that Southwest Key adheres to the statutorily allowed rate for executive compensation.

Response:
ACF acknowledges OIG's recommendation that ACF ensure that Southwest Key adheres to the statutorily allowed rate for executive compensation. As all of these executive compensation costs were charged indirectly, ACF notes that the HHS Cost Allocation Services (CAS) is the representative office for the cognizant agency, with the responsibility for the review and approval of indirect costs included in Southwest Key's approved indirect cost rate. ACF will work with CAS to ensure that Southwest Key is only charging salary costs that adhere to statutory limitations on executive compensation.

Recommendation 6:
Review Southwest Key's bonus policy to ensure it meets Federal requirements.

Response:

ACF generally concurs with the OIG's recommendation. ACF is monitoring Southwest Key and will take into consideration the work performed and the recommendations made by the OIG to determine a final resolution of Southwest Key's grant management performance in regards to the establishment and maintenance of policies over bonuses.

Summary

In closing, ACF appreciates the work OIG has performed, the results of which will assist with the monitoring of the UAC program.

Again, thank you for the opportunity to review this draft report. Please direct any follow-up inquiries to Janice Davis-Caldwell, Director, Family Protection & Resilience Portfolio, Office of Grants Management, Administration for Children and Families.

Sincerely,

/Lynn A. Johnson/

Lynn A. Johnson
Assistant Secretary
for Children and Families