

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: Harrison County Community Action Agency, Inc.
Docket Nos. 75-5 and 76-7
Grant No. H-3034
Audit Control Nos. 04-46656 and
04-56647
Decision Nos. 35 and 36

DATE: March 14, 1977

DECISION

This is an appeal from determinations disallowing costs upon audit. Since 1968, The Harrison County, Mississippi Civic Action Committee, Inc., ("Grantee") has been administering the County Head Start program authorized by the Economic Opportunity Act of 1964, as amended (Tit. II, Part B, Section 222). During each of the program years 1973 and 1974, the period here pertinent, the Federal contribution to the Program was to an amount of about \$2,000,000, and that of non-Federal sources a sum of approximately \$400,000.00. Because of the similarity in the nature of the 1973 disallowed cost to one of the disallowed cost items in 1974, we consolidated the respective dockets for consideration and decision.

I. (Docket No. 75-5)

On March 13, 1975, the Assistant Regional Director for Human Development, Region IV ("ARD") communicated to Grantee a decision of the Audit Appeal Board disallowing the sum of \$9,100 expended by Grantee in the 1973 funding year in connection with the renovation of two facilities employed in the Head Start program, and demanding a refund of this amount out of non-Federal sources. It appears that the contracts for the renovation work were let in consequence of a classified advertisement in the form of a legal notice inserted by the Grantee in a local newspaper to the one contractor who responded. Disallowance was for failure of the Grantee to solicit, directly, quotations of bids from qualified contractors which normally would result in competitive bidding, as required by applicable official issuances. Grantee argues that there is no procedure available to determine the fair market value of the work performed or to determine what the cost would have been had contractors competed for the job.

While the record discloses vague suggestions by the Grantee that, in addition to advertising, it has also made additional "contacts" with contractors and suppliers, there is no reason for doubting that grantee did not make an earnest effort to obtain more than one bid and that it did not, in fact, obtain competitive bids. It is equally clear that the grantee did not seek a waiver of the bidding requirement from any competent official. The basis for the bidding requirement is found in Office of Economic Opportunity, Community Action Program, Cap Memo #64 B-7, June 22, 1967; Grantee's Management Instructions, Purchasing, 3.2; OEO Instruction 7001-01a, b(2) (d), and CAP Guide: Grantee Financial Control Technique, OEO Guidance 6801-1, C.4, (August 1968).

Competitive bidding requirements are not a product of bureaucratic caprice, nor are they merely technical, as suggested by the Grantee. They are more properly the product of experience going to the very essence and integrity of the audit function in the Federal grants field concerned with administering annual expenditures of billions of dollars of public funds and requiring alertness to minimize as much as possible opportunities for waste, inefficiency, and fraudulent practices.

Similarly, we see no merit in grantee's argument that insistence on bidding from more than one source will tend toward a restrictive selectivity of bidders to the detriment of small businessmen and minorities. A short answer to this argument is that two out of nine topics addressed in the General Conditions attached to the Grant Statement of the Grantee herein caution against discriminatory practices, and that there is nothing in the nature of the requirement that would necessarily or logically produce the dire consequences suggested by the Grantee. Moreover, the Economic Opportunity Act of 1964, as amended, 42 USC 2835(a)(d); id. 2942(n) explicitly vests far-reaching regulatory authority (to establish "such policies, standards, criteria, and procedures prescribing rules and regulations"), and wide discretion ("and generally perform such functions and take such steps as he may deem to be necessary or appropriate to carry out the provision of this chapter") in the Director and his subordinate officials. Power to disallow

costs is expressly conferred upon OEO as an incident of the audit process, 42 USC 2835(c), and OEO regulations were made applicable to the DHEW pursuant to delegation of authority as to Head Start, 34 F. R. No. 182. It follows that the issuances of the OEO concerning competitive bidding applicable to Head Start projects of which Grantee had been repeatedly apprised from 1971-74, are within the statutory premises and are legislative rather than merely interpretive in character. Cf, Skidmore v. Swift and Co., 323 US 134, 140 (1944). This being our view of the matter, Grantee's challenge directed to the alleged lack of wisdom in the bidding regulations must fail as irrelevant.

Insofar as the \$9,100 cost disallowed in the 1973 audit is concerned, Grantee has alleged a variety of extenuating circumstances for failing to obtain competitive bids, viz, low profit margin on work performed on Government projects, involved procedure for obtaining payment, a painter's strike, pressure to have renovation jobs completed before the opening of the centers for the up-coming school year due to delay occasioned by changing local health requirements, etc. As to the last cited justification, information supplied by the Grantee at our request affords no substantiation for the asserted fact. But irrespective of the essential correctness of the matter asserted in justification or extenuation of the non-compliance, and without deciding whether the scope of review of this Board is limited by the same considerations as would be applicable to judicial review of administrative action, see, e.g., Amer. Fed. A.F.L. - C.I.O., etc., v. Secretary of Labor, 484 F.2d 339 (CCA.6, 1973); Gaines v. Martinez, 353 F. Supp. 780 (1972), it is our view that the ARD had sufficient statutory authority in the premises for the exercise of a discretionary judgment and that he did exercise his discretion with respect to the Grantee's excuses based on hardship in a reasonable manner, and with due regard to the evidence and to the applicable rules. In Oregon State-wide Allocation Plan, Docket No. 75-7, Decision No. 22, this Board held that it will not substitute its discretion for that of the Regional Director where his decision is in accordance with the rules and his exercise of discretion is reasonable. Furthermore, even if all of the circumstances alleged by the Grantee by way of extenuation be conceded, arguendo, no reason or explanation appears for Grantee's failure to seek a waiver of the bidding requirement from the Regional

Office. (Part D. Head Start Manual 6108-1 September 1967. See, also, OEO Inst. 7001-01a(3).)

Accordingly, we sustain the disallowance in the sum of \$9,100 charged to the grant in the 1973 program year.

II. (Docket No. 76-7)

On March 1, 1976, the ARD informed the Grantee of his approval of the June 11, 1975 determination upon audit to disallow the following expenditures charged to the grant for the program year ending July 31, 1974:

1. For failure to comply with the competitive bidding requirements in connection with renovation contracts and purchase of equipment...\$13,700.00.

2. For excessive accumulation of educational and housekeeping supplies...\$22,449.

3. For inadequate documentation in connection with expenditures of Parent Activity Fund...\$4,745.00.

1. The determination of non-compliance with bidding requirements as to the 1974 contracts rests on the same legal premises as those which led to the disallowance for an identical reason in the 1973 funding year. Significantly, in its representation to the Audit Appeal Board in opposition to the 1974 disallowance, the Grantee did not argue any extenuating circumstances but relied on the bold proposition that "Once an agency has legally advertised for bids that the technical requirements are satisfied."

For the reasons outlined with reference to the 1973 disallowance, we reject grantee's argument with reference to the 1974 parallel non-compliance, and sustain the disallowance in the sum of \$13,700.00.

2. It appears that allegedly excessive purchases of educational materials accounted for \$18,599. This was the only amount questioned by the Grantee's CPA. The difference between this amount and the amount of \$22,449 (\$3,850) represents cost incurred for the purchase of janitorial supplies, office supplies and cafeteria items disallowed by the Regional Office notwithstanding its adoption, generally, of the CPA's findings

The disallowance was on the ground of instructions and policy statements which identify excessive accumulation of inventory by a grantee as a ground for questioning costs for unreasonableness, especially when the accumulation occurs near the end of a grant period, which was the case here. Furthermore it is claimed by the Regional office that the educational supplies were not actually needed until the second month following the commencement of the 1974-5 school year. In response to our request for expanding the record the Grantee states that "The materials were needed at the beginning of the program year" (emphasis ours), incidental to a training program for the teaching staff, without specifying the portion of the supplies needed for that purpose.

Alleged inflation and the scarcity of paper products during the relevant period were circumstances invoked by the Grantee in justification, and it contends that these have had the effect of changing the OEO policy against more-than-ordinary accumulation of supplies which it said were, in some unexplained way, inconsistent with the policy of the Office of Child Development (OCD). Grantee's auditor commented that while grantee might indeed have saved money by increasing inventory in the manner it did, this consideration might have been outweighed by loss due to obsolescence and pilfering by employees. There is nothing in the file to show that either the positive or negative effects of the claimed over-acquisition have in fact materialized. The Grantee's auditor did recommend that if Grantee desired to continue such practice, it should institute a perpetual inventory system as recommended in relevant guidance material.

Under Criteria for Questioning Costs, OEO Manual 2410-1 E.1, (July, 1968) lists "costs which are unreasonable", and gives as an example, purchase of a six months' supply of materials during the last month of the grant year, while stressing the distinction between costs which are questionable and those which are unallowable. This instruction appears, in substance, in OEO Manual 2410-1, May 1973, Accounting-System Survey and Audit Guide for OEO Grants, VI, d.5. (p. 25). See, also, id. Appendix K.I.E.1, Section F.5, and Appendix A p. 13 which addresses the test of whether the purchased items, especially toward the end of the funding period, "appear to be necessary to the completion of the program." OEO Guidance 6801-1 CAP Management Guide, Grantee Financial Control Techniques, p. 20 contains the direction of Perpetual Inventory Control Records when purchases are not made on the basis of need.

It is readily seen that the official issuances relevant to the item of alleged excessive inventory, are phrased in terms such as "reasonable", "need" "excessive", obviously calling for evaluative exercise of discretion by responsible officials. But the power to "evaluate" is explicitly granted to OEO in the Economic Opportunity Amendments of 1967, 42 USC §2835(b). Even under the Grantee's view of the matter, it is highly unlikely that all or even the greater part of the material would have been required for the teachers' training program during the first month of the school year. It, therefore, appears that the disallowance determination, insofar as it relates to the amount of \$18,599, representing cost of purchased educational materials, is based on undisputed evidence. The ARD's finding that this purchase was unreasonable or excessive, while not a compelled one in view of all the circumstances, including Grantee's concern about prospective scarcity of paper products and a prevailing inflationary trend, represents a permissible - clearly not an obviously erroneous - inference from the aggregate of the evidence. We, therefore, sustain the disallowance to the extent questioned by the external auditor in the amount of \$18,599.

The basis for the disallowance of the sum of \$3,850 representing allegedly excessive accumulation of material other than educational supplies is less clear. At p. 11 of their report for the program year 1974, the management auditors made the following comment: "Our tests with regard to this inventory were observation followed by test counts and vouching. The portion of the inventory that appears excessive under the above guidelines is included in the inventory of educational supplies." (Emphasis supplied). In his response of January 18, 1976 to our Statement Identifying Issues, the ARD employs a highly technical explanation for including the cost of the non-educational supplies in the disallowance figure, to the effect that the creation of a "(voluntary) reserve fund of \$22,449 of supply inventory in this instance was merely an accounting device to circumvent the proper classification of unapplied fund balance." This argument is somewhat less than persuasive, particularly when considered in the light of the practical rationale supplied by the management auditor for not questioning the cost of this part of the purchased supplies.

Furthermore, OEO Manual 2410-1, p. 25, (July, 1968) contains the following provision: "Before a cost disallowance decision is made, the Grantee will be given an opportunity to present any additional information or justification which may have a bearing on the ultimate allowability of the costs questioned."

In the proceeding before us, the Grantee was not accorded such opportunity. The record shows that on March 10, 1975, the Regional Audit Director, HEW Audit Agency, Region II, forwarded a list of questioned items to the Grantee which stated only \$18,599 as the amount questioned for excessive accumulation of supplies, and requested that grantee respond "to each item identified."

In the letter of the ARD of March 1, 1976, he informed Grantee that the Audit Appeal Board sustained the action of the Technical Assistance Chief, Office of Financial Management, DHEW, shown in his report of June 11, 1975. That report informed the Grantee that "deficiencies in the following areas detailed by your auditor are hereby sustained" and proceeded to list as "questioned costs disallowed" (Underscoring ours), a disallowance, under the heading of "supplies", in the amount of \$22,449 - an amount not to be found among the questioned costs. Nor does the record before us indicate whether the amount of \$3,850 appeared as a carry-over in the 1975 budget. In view of this confusion, it can not fairly be said that the Grantee was clearly advised of his right to offer information or justification concerning the cost for non-educational supplies.

The Board sustains the appeal as to this cost item of \$3,850.00.

3. Involvement of parents of Head Start enrollees in the Head Start program through active participation in its educational and administrative activities has been regarded by the OEO and OCD as of great importance to assure the overall success of the program. Memorandum of Understanding Between OEO and DHEW incidental to Delegation of Authority, June 30, 1969; Head Start Policy Manual Instruction I-31 Section B.2, The Parents, 8/10/1970. In furtherance of such involvement, Parent activity

funds are usually provided for in Head Start budgets. During the 1974 funding year, Grantee charged to the Grant Parent Activity costs in the amount of \$4,745. This cost item was questioned and ultimately disallowed. It appears that contrary to applicable instructions, see Head Start Manual, supra, and MCD IV/40, Instruction #35 (June 2, 1977), there was a lack of internally created parent budget approved by the Policy Council with participation from Center parent committees. Also, while the parents could elect to use the accounting system of the Grantee as their own, no Policy Council minutes reflecting such election were found. Additionally, Grantee was unable to produce any receipts or canceled invoices evidencing the manner in which the funds were expended.

While the grantee asserts that a budget had informally been agreed upon and that an official of OCD had orally authorized expending the funds as represented to be authorized by the Policy Council, it does not controvert the basic fact that no documentation required by relevant instructions and by principles of sound management practices were made available to the private or official auditors.

There is merit in Grantee's contention that official issuances in the area of parent fund activity contain a degree of built-in conflict between provisions for a large measure of autonomy for parents and their groups in administering their activities and funds on one hand, and the ultimate responsibility and accountability of Grantee for such funds, on the other, OEO Guide 6801-1 CAP Management Guide, Grantee Financial Control Techniques, Chapter I. But the solicitude toward parents manifest in the guidance material nowhere goes as far as to deprive the Grantee of the right or relieve it of the duty to review and exercise final judgment concerning controls established by the parent groups in accordance with Instruction # 35, especially in a situation exemplified by the instant proceeding where it is claimed that Grantee agreed that its accounting method be used to account for the parents fund. Allegation of conflict in regulatory purposes is not, of itself, a basis for a finding of lack of authority in the administrative officials to require the grantee in the circumstances shown, to account for the funds charged to the grant, Gaines vs. Martinez, supra, especially where there is even the absence of a showing that the funds were spent in furtherance of the purposes of the Head Start grant. It follows

that the disallowance of the cost of parent activity funds (\$4,745.00) was proper, and Grantee's appeal concerning this determination is denied.

In his audit report for the 1974 program year, the agency accountant questioned the sum of \$624 representing salary increases in excess of the percentage allowed by pertinent applicable instructions. In several submissions to this Board the parties refer to this item as if it constituted a subsisting issue.

We decline consideration of this matter. The charter of this Board, 45 CFR. 16.2(a); 5, is clearly to the effect that our jurisdiction is limited to determinations. In the absence of any determination disallowing the sum of \$624.00, there can be no dispute constituting an issue within the meaning of id. Section 16.1.

In his representation to this Board the Grantee takes sharp issue with a statement by the ARD in his letter of March 13, 1975, to the effect that in disallowing costs incurred without adhering to acceptable bidding procedure, the Audit Appeal Board was strongly influenced by grantee's commission in the past of "the same type of violation" every year since 1970. Grantee argues, in effect, that this statement shows prejudice and improper motive on the part of the ARD and the Audit Appeal Board, since a disallowance for failure to comply with bidding requirements had occurred only once (in 1970).

We do not read the expression "same type of violation" in the limited sense of non-compliance with bidding requirements, but in the more expanded sense of deficiencies in fiscal management. Thus understood there is abundant evidence in the file to support the ARD's statement. We add that we find no impropriety in the consideration by the Regional auditing officials of a grantee's past violations of official policy and acceptable management practices involving handling of grant funds, as a factor in the exercise of discretion concerning allowability of a cost item in a current funding year. Amer. Fed., A.F.L.-C.I.O., etc. v. City of Cleveland and Secretary of Labor., supra.

Accordingly, we sustain the disallowance in the amount of \$9,100.00 for non-compliance with bidding requirements in FY 1973, (Docket No. 75-5), and the disallowance of the amount of \$13,700.00 for an identical reason, in FY 1974 (Docket No. 76-7).

We sustain the disallowance in the reduced amount of \$18,599, on account of excessive accumulation of educational materials, and the disallowance in the amount of \$4,745.00 representing expenditures of Parent Activity funds, for inadequate documentation in FY 1974 (Docket No. 75-7.)

/s/ Irving Wilner, Panel Chairman

/s/ Edward York

/s/ Thomas Malone