

Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Bright Beginnings for Kittitas County
Docket No. A-14-118
Decision No. 2623
March 10, 2015

DECISION

Appellant Bright Beginnings for Kittitas County (Bright Beginnings), a Head Start/Early Head Start grantee, filed a Notice of Appeal (NA) in this matter on September 21, 2014. The appeal seeks review of a final decision by the Administration for Children and Families (ACF) to disallow \$126,398 in Early Head Start grant funds. ACF based the disallowance on a finding in a September 24, 2012 Audit Report by an independent auditor and a recommendation by the Office of Inspector General (OIG) of the Department of Health and Human Services (DHHS) after the OIG's review of that report. The audit found that although the funds had been awarded for operating Bright Beginnings' Early Head Start program, Bright Beginnings instead used the funds to pay building construction costs and did so without obtaining prior approval from ACF. ACF concluded this was a violation of OMB Circular A-122, Appendix B, ¶15(b)(1), which requires prior approval for capital expenditures, and disallowed the funds under 45 C.F.R. § 74.62(a)(2), which authorizes ACF (and other DHHS agencies) to disallow costs charged to grants for material failures to comply with the terms and conditions of the grant award.

Bright Beginnings acknowledges in its notice of appeal that its former Executive Director "used funds intended for the operation of [Early Head Start] to pay for building expenses" and that this "[was] not allowed under the conditions of the funding" but asserts that the Executive Director did so "without the knowledge and approval of the [Board of Directors] and management staff" and that the Board and program staff "did not willfully intend to disregard federal laws" NA at unnumbered pages 1, 2, 8. Bright Beginnings also asserts as reasons for reversing the disallowance its termination of the Executive Director who made the impermissible fund transfers; ACF's initial grant of retroactive approval, subsequently withdrawn; and, Bright Beginnings' alleged partial repayment of the transferred funds.

For the reasons stated below, we uphold the disallowance.

Applicable Law

The Head Start Act (Act) authorizes funding for the Head Start program to provide comprehensive developmental services to preschool children as well as to infants and toddlers, the latter through the Early Head Start program; both programs serve primarily low-income children. 42 U.S.C. § 9831 *et seq.* Compliance with the administrative requirements in Part 74 of title 45 of the Code of Federal Regulations is a term and condition of Head Start grant awards. 45 C.F.R. § 1301.10(a). The administrative requirements include the financial and management requirements in 45 C.F.R. Part 74.¹ One of those requirements is that a grantee provide for effective control over and accountability for all funds, property and other assets, safeguard those assets and assure that they are used solely for authorized purposes. 45 C.F.R. § 74.21(b)(3). To that end, a grantee must maintain “[r]ecords that identify adequately the source and application of funds for HHS-sponsored activities[,] . . . [w]ritten procedures for determining the reasonableness, allocability and allowability of costs in accordance with the provisions of the applicable Federal cost principles and the terms and conditions of the award . . . and [a]ccounting records, including cost accounting records, that are supported by source documentation.” 45 C.F.R. § 74.21(b)(2), (6), (7).

Section 74.25(b) requires grantees to report deviations from budget and program plans, and request prior approval for budget and program plan revisions. Section 74.28 requires that “[w]here a funding period is specified, a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period[.]”

Head Start grantees also must comply with HHS grants policies such as the Office of Management and Budget Circular A-122 (OMB A122) entitled “Cost Principles for Non-Profit Organizations.” *See* 2 C.F.R. Part 230 (2008-2013) (codifying OMB Circular A-122); 45 C.F.R. §74.27(a) (making OMB A-122 applicable to Head Start grants). OMB A-122 establishes principles for determining costs of grants, contracts and other agreements with non-profit organizations. Appendix A of the Circular provides information about the allowability, reasonableness, and allocability of costs charged to Federal awards. To be allowable, costs must be reasonable for the performance of the award and allocable to it. *See* 2 C.F.R. Part 230 Appendix (App.) A, ¶ A.2.a. Costs are reasonable if they “do[] 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 costs.” *Id.* ¶ A.3. Costs are allocable if they are incurred specifically for the award. *Id.*

¹ Effective December 26, 2014, Part 74 of Title 45 of the Code of Federal Regulations was removed and reserved and a new Part 75 was added. *See* 79 Fed. Reg. 75,871, 75,889 (Dec. 19, 2014). By this change, DHHS adopted OMB’s uniform administrative requirements, cost principles and audit requirements for Federal awards to non-Federal entities. We cite to Part 74 since that was the applicable regulation at the time of the grant award at issue.

¶ A.4.a(1). Grantees must adequately document costs charged to an award. *Id.* ¶ A.2.g. Capital expenditures for land or buildings, including expenditures for improvements to land or buildings which materially increase their value, are unallowable as direct charges, except where approved in advance by the awarding agency. *Id.* at App. B, ¶ 15.b(1).

If a grantee “materially fails to comply with the terms and conditions of an award,” ACF “may . . . [d]isallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.” 45 C.F.R. § 74.62(a)(2).

Factual Background

A. The Grant Award and Review Findings

Bright Beginnings operates Head Start and Early Head Start programs under federal grant awards. Bright Beginnings applied for and received a grant award (grant number 10CH0142) for the budget period January 1, 2011 through December 31, 2011. ACF Ex. 1. The grant award had a total approved budget of \$2,349,591 with no funding for building construction.² *Id.*

The firm CliftonLarsenAllen, LLP, conducted an independent audit of Bright Beginnings’ financial statements for the year ended December 31, 2011 and issued a report on September 24, 2012. ACF Ex. 2. The auditors used Government Auditing Standards to comply with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. *Id.* As relevant here, the auditors found (audit finding 11-03) that Bright Beginnings “did not request approval from the [DHHS] before a budget revision . . . [that] drew down Early Head Start funds intended for operating activities, to pay construction costs associated with the building expansion project . . . [but] could not provide any support that substantiated the budget revision approval by [ACF’s] Office of Grants Management.” *Id.* at unnumbered page 21. The amount of costs identified as being spent on construction without prior approval was \$126,398. *Id.* Bright Beginnings admitted this audit finding, stating that its former Executive Director “fraudulently used the Early Head Start funds to pay for USDA [United States Department of Agriculture] expenditures.” ACF Ex. 4, at 2; ACF Ex. 5, at 5. Bright Beginnings indicates that USDA was providing loans for the construction, and that the Executive Director used the

² Bright Beginnings’ Head Start/Early Head Start programs received additional funding from DHHS under an ARRA Head Start expansion award and also received funding from the United States Department of Agriculture (USDA) and United States Department of Education (USDE). ACF Ex. 2 at unnumbered page 25.

Early Head Start operating funds to make construction payments pending release of USDA loan funds. NA at unnumbered page 2; *see also* ACF Ex. 4 (OIG Clearance Document), at 2 (stating that Bright Beginnings used Early Head Start funds to pay construction costs “[p]rior to obtaining a USDA loan[.]”).

The OIG reviewed the audit report and found Bright Beginnings’ expenditure of Early Head Start grant funds to pay the construction costs to be a material weakness. ACF Ex. 3, at 3. The OIG recommended, *inter alia*, that any unallowable costs (identified by the OIG as \$126,398) be determined and returned. *Id.* ACF concurred with the audit finding and OIG’s recommendations. ACF Ex. 4, at 2. In a letter dated August 19, 2014, ACF notified Bright Beginnings it was taking a disallowance in the amount of \$126,398. ACF Ex. 5.

B. Procedural History of Appeal

Bright Beginnings filed a timely NA, attached to which were Appendices (App.) A-F. On September 26, 2014, the Board sent the parties an Acknowledgment of Notice of Appeal (Acknowledgment) which instructed the parties to submit their briefs and appeal files to the Board and each other within 30 days of receiving the Acknowledgment. On September 29, 2014, ACF moved to consolidate this appeal with another appeal filed by Bright Beginnings, docketed as Bright Beginnings for Kittitas County, Docket No. A-14-113. By email dated September 30, 2014, the Board gave Bright Beginnings one week to respond to the motion; Bright Beginnings did not file a response. On October 16, 2014, the Board issued a ruling denying the motion.

Bright Beginnings did not file a brief or appeal file within the 30-day period specified in the acknowledgment so on November 26, 2014, the Board issued an Order to Show Cause Why Appeal Should Not Be Dismissed. On December 5, 2014, Bright Beginnings responded that it thought that the appeal it filed, *i.e.*, the NA, was all it needed to file. On January 5, 2015, the Board issued an order stating that it would construe Bright Beginnings’ NA and attachments as its brief and appeal file and gave ACF 30 days to file a responsive brief and appeal file. On February 4, 2015, ACF filed Respondent’s Brief In Support of Disallowance and an appeal file containing ACF Exhibits (Ex.) 1-9.

Discussion

A. Neither lack of intent to violate the regulations nor lack of knowledge or approval by the Board of Directors is a basis for overturning the disallowance.

Bright Beginnings diverted \$126,398 in funds budgeted for Early Head Start program operations to fund construction costs without obtaining prior approval from ACF. This is a violation of section 74.25(b), which requires grantees to report certain deviations from

budget and program plans, and request prior approval for budget and program plan revisions. As relevant here, grantees are required to obtain prior approval of a budget revision that involves a “[c]hange in the scope or objective of the project or program[.]” 45 C.F.R. § 74.25(c)(1). Clearly, using funds budgeted for Early Head Start program operations to pay construction costs instead is a “change in the scope or objective of the . . . program.” This diversion of funds is also a violation of OMB Circular A-122, App. B ¶ 15, which requires that capital expenditures for land or buildings, including expenditures for improvements to land or buildings which materially increase their value, be approved in advance by the awarding agency. *Id.* at App. B ¶15.

Bright Beginnings does not dispute that it used Early Head Start operating funds to pay for construction costs without obtaining prior approval from ACF; nor does Bright Beginnings dispute that this was not an allowable use of the operating funds. Instead Bright Beginnings argues that its violation of the regulations and the cost principle discussed above should be excused because the diversion was “not willfully intend[ed]” and the diversion was done by its Executive Director without knowledge of or approval by the Board of Directors. NA at unnumbered page 1.

Bright Beginnings has presented no evidence supporting these assertions but assuming their truth, neither lack of intent to violate the regulations and cost principles nor the Board of Directors’ lack of knowledge or approval of the Executive Director’s actions provides a basis for overturning the disallowance. The requirements for prior approval in section 74.25(b) and (c) do not contain any exception for unintended failures to seek prior approval or otherwise provide that “a disallowance is appropriate only if the grantee intended this violation of the regulation.” *Bright Beginnings for Kittitas Cnty.*, DAB No. 2608, at 6 (2014) (addressing Bright Beginnings’ contention that it violated the regulation at issue there due to misunderstanding its terms). Nor does the cost principle requiring prior approval in 2 C.F.R. Part 230 App. B ¶ 15 contain such an exception.

In addition, the Board has consistently held that “it is a fundamental principle of grants management that a grantee is required to document its costs, and bears the burden of demonstrating the allowability and allocability of costs for which it received federal funding.” *Marie Detty Youth & Family Servs. Ctr., Inc.*, DAB No. 2024, at 3 (2006). Bright Beginnings has failed to meet that burden. The construction costs charged to Bright Beginnings’ Early Head Start program grant were not allowable costs of or allocable to that grant absent ACF prior approval to revise the grant budget to allow this deviation, and Bright Beginnings has not presented any evidence that it had such prior approval. Indeed, Bright Beginnings does not even dispute that it did not have prior approval.

Bright Beginnings' argument that it should not be held responsible for the actions of its Executive Director in diverting the funds because its Board of Directors did not know about or approve the diversion must also fail. The Board has consistently held that a grantee's Board of Directors is responsible for the actions of the employees who carry out its Head Start program. *E.g. Pinebelt Ass'n for Cmty. Enhancement*, DAB No. 2611, at 9 (2014); *Rural Day Care Ass'n of Ne. N.C.*, DAB No. 1489, at 27, 55 (1994), *aff'd Rural Day Care Ass'n of Ne. N.C. v. Shalala*, No. 2:94-CV-40-BO (E.D. N.C. Dec. 20, 1995). Thus, Bright Beginnings bears ultimate responsibility for the unapproved diversion of funds by its Executive Director, and neither the fact that Bright Beginnings may have been ignorant of the Executive Director's unlawful use of grant funds at the time the funds were expended nor the fact that it subsequently fired him for his conduct is a basis for reversing the disallowance.

Based on the foregoing, we conclude that Bright Beginnings has shown no basis for overturning the disallowance of the construction costs.

B. Bright Beginnings' argument in equity provides no basis for overturning the disallowance.

Bright Beginnings states its belief that the Executive Director's motivation for diverting the funds was "to pay for building expenses until the remaining balance of [the] USDA loan funds [which were supposed to fund the construction] were released" NA at unnumbered page 2. Bright Beginnings explains, "while [the Executive Director's] actions were not allowed under the conditions of the funding, it is believed his intent was to ensure the completion of the building project and a secure future for the provision of [Head Start] and [Early Head Start] services for the children and families most in need of these services." *Id.* at unnumbered page 8. Bright Beginnings' suggestion that the Board should overturn the disallowance based on what Bright Beginnings portrays as a positive motivation for the unlawful use of program funds is misplaced. This amounts to an equitable argument, which is not a basis for overturning a legally justified disallowance. The Board has consistently held that it "has no authority to waive a disallowance based on equitable principles." *Municipality of Santa Isabel*, DAB No. 2230, at 11 (2009); *accord Bedford Stuyvesant Restoration Corp.*, DAB No. 1404, at 20 (1993) (citing 45 C.F.R. § 16.14 and stating that the Board "is bound by all applicable laws and regulations" and "cannot provide equitable relief"). As discussed above, the regulations here clearly authorized ACF to disallow the expenditure of Early Head Start program funds for construction given Bright Beginnings' failure to obtain prior approval for that use of funds. Accordingly, we reject Bright Beginnings' arguments for equitable relief from the lawfully taken disallowance.

C. ACF’s decision to retract its initial retroactive approval of the request to re-budget the disallowed funds and its ultimate decision to not grant retroactive approval are not bases for overturning the disallowance.

Bright Beginnings complains that ACF initially approved a request for retroactive approval to rebudget the disallowed funds so that they could be used for construction but then withdrew that approval. NA at unnumbered pages 5-6. The record contains a letter, dated July 30, 2013, in which the Regional Program Manager in ACF’s Region X office stated --

The Office of Head Start Region X received your request dated July 19, 2013, to rebudget ARRA Early Head Start funds for Fiscal Year 2011. Since the request is for Fiscal Year 2011, a retroactive approval would need to be granted. After a review of this request, both the Office of Head Start Region X and the Office of Grants Management Region X retroactively approve Bright Beginnings for Kittitas County’s (BBKC) request for the rebudget of \$126,398 from Personnel and Fringe to Facility/Construction in their ARRA funded Early Head Start expansion grant (10SA0142) during the Fiscal Year 2011. The funds were used for the construction of the facility located at

ACF Ex. 7 (emphasis added). In a subsequent letter, dated May 12, 2014, the Acting Grants Management Officer in ACF’s Region X office retracted the retroactive approval, stating, in part,

[B]ased on our re-review of finding 11-03 in the subject audit report for the period ended 12/31/2011, the funds in question of \$126,398 were not ARRA Early Head Start funds and the suggested retroactive approval was not an appropriate resolution for this finding.

ACF Ex. 8.³ Thus, ACF ultimately concluded that its initial decision to grant retroactive approval was based on a mistake about the grant funds involved in the audit finding and denied retroactive approval on the ground it was not an appropriate resolution of the audit

³ The May 12, 2014 letter stated what appears to be a further reason for the retraction, that “[t]he implied approval in the [July 30, 2013] letter was not certified in the form of a Notice of Grant Award which holds legal authority for matters relating to federal grants.” *Id.* Because we find no basis to overturn ACF’s ultimate denial of retroactive approval, we need not discuss whether this was a valid reason.

finding.⁴ Bright Beginnings has cited no law that would preclude ACF’s withdrawing its previously granted retroactive approval, and we find no legal basis for disturbing such an administrative decision.

If Bright Beginnings is arguing that ACF should be estopped from taking the disallowance because it withdrew initially granted prior approval, that argument must fail. It is well-established that “the government cannot be estopped absent, at a minimum, a showing that the traditional requirements for estoppel are present (i.e., a factual misrepresentation by the government, reasonable reliance on the misrepresentation by the party seeking estoppel, and harm or detriment to that party as a result of the reliance) and that the government’s employees or agents engaged in ‘affirmative misconduct.’” *Oaks of Mid City Nursing & Rehab. Ctr.*, DAB No. 2375, at 31 (2011), citing *Office of Pers. Mgmt. v. Richmond*, 496 U.S. 414, 421 (1990), and *Pacific Islander Council of Leaders*, DAB No. 2091, at 12 (2007) (“equitable estoppel does not lie against the federal government, if indeed it is available at all, absent at least a showing of affirmative misconduct.”). Bright Beginnings does not allege affirmative misconduct by ACF or its employees. Accordingly, there is not even a potential argument for estoppel.

Bright Beginnings also has not pointed to any basis for overturning ACF’s ultimate decision not to grant retroactive approval for expending Early Head Start program funds on construction that not only was not part of that program’s approved budget but, in fact, was supposed to be paid for with loan funds from another federal department. Where a grantor agency’s governing regulations and policies permit retroactive approval, the Board “will not interfere when the federal agency appropriately exercises its discretion.” *Child Dev. Council of Acadiana, Inc.*, DAB No. 2574, at 10 (2014), citing *Econ. Opportunity Atlanta, Inc.*, DAB No. 313 (1982). While Bright Beginnings complains about ACF’s ultimate denial of retroactive approval, it does not allege an abuse of discretion. Assuming ACF had discretion to grant retroactive approval,⁵ we find no abuse of discretion in ACF’s denying retroactive approval. While the denial letter’s

⁴ ACF also asserts that the initial letter granting retroactive approval was not binding because it was not signed by the Assistant Secretary for Children and Families who, ACF says, is the cognizant officer for purposes of a request to re-budget amounts exceeding \$100,000. ACF Response at 13-15. We need not address this assertion since we have already concluded that ACF was not precluded from withdrawing the retroactive approval.

⁵ In *Child Development Council of Acadiana, Inc.*, DAB No. 2574 at 7, the Board applied the requirements of Section 644(g) of the Head Start Act, 42 U.S.C. § 9839(g), and the implementing regulations at 45 C.F.R. Part 1309 and found that ACF “properly disallowed . . . construction costs because [the grantee] failed to obtain from a responsible HHS official the necessary prior written approval for the expenditures.” The Board found “reasonable” ACF’s reading that the statute and regulations “preclude ACF from granting a request for retroactive approval where, as in this case, a grantee has used Head Start funds for unauthorized capital expenditures without establishing eligibility and securing ACF’s approval prior to construction.” *Id.* at 11. See also *Marie Detty Youth & Family Servs. Ctr., Inc.*, DAB No. 2024, at 38 (explaining that section 644(g) indicates by its language and the specific determinations the Secretary must make that ACF must approve such expenditures prior to construction).

explanation that “the suggested retroactive approval was not an appropriate resolution for [the audit] finding” is arguably a bit sparse, given the nature of the audit finding the letter referred to, the denial can hardly be characterized as “based on unsubstantiated conclusions or on bases so insubstantial that the decision fairly can be described as capricious.” *Child Development Council of Acadiana, Inc.*, DAB No. 2574 at 10, quoting *Arizona Affiliated Tribes, Inc.* DAB No. 1500 (1994), citing *Economic Opportunity Atlanta, Inc.*, DAB No. 313 (1982). On the contrary, the OIG review described the audit finding (finding 11-03) as a “material instance of noncompliance and a material weakness.” ACF Ex. 3, at 3.

D. Bright Beginnings’ alleged partial repayment of the diverted operating funds is not a basis for overturning any part of the disallowance.

Bright Beginnings suggests that the disallowance should be reversed because it allegedly repaid \$117,710.87 of the \$126,398 wrongfully diverted Early Head Start operating funds. Bright Beginnings lists five alleged transfers of USDA mortgage funds to Bright Beginnings’ “main Operating Account” between March 19, 2012 and August 9, 2012. NA at unnumbered page 3. However, Bright Beginnings has not submitted any documentation of the listed partial repayments (or any other repayments).⁶

Even assuming the alleged repayments did occur, that would not be a basis for reversing the disallowance or any part thereof. Starting with the obvious, partial repayment would not account for the total amount of the disallowed expenditures.⁷ In addition, Bright Beginnings has not shown that the “main Operating Account” to which it allegedly transferred the \$117,710.87 is the same account from which the Early Head Start operating funds were diverted or any operating fund account benefitting only the Early Head Start program. As we previously noted, Bright Beginnings had multiple sources of funding from multiple federal departments. Thus, as ACF notes, ACF Response at 17 n.6, “returning funds to Bright Beginnings main operating [ac]count does not constitute repayment to ACF[,]” or at least cannot be determined to constitute repayment given the record before us, which, as indicated above, contains no documents supporting any repayment.

⁶ We also note that the fifth fund transfer Bright Beginnings identifies in its Notice of Appeal states that the funds identified for that transfer (\$33,000) “were transferred into the USDA account from the general operating account to cover mortgage expense of \$68,064 (a difference of \$35,064).” Bright Beginnings counts the \$35,064 as part of the \$117,710.87 it claims to have repaid but does not explain how this result could occur from a fund transfer to the USDA account rather than from it.

⁷ Bright Beginnings states it “believe[s] that [its Executive Director] may have paid the remaining balance of OHS operating funds of \$8,697.13 using school district revenues, however we cannot provide substantiating evidence that \$8,697.13 were deposited from school district unrestricted funds back into US Bank main Operating Account.” *Id.* On its face, this assertion is so speculative that it requires no further discussion.

In addition, even assuming the “main Operating Account” was the grant account from which the funds were diverted (or another account holding funds that could be expended only for Early Head Start operations) and that the listed repayments actually occurred, Bright Beginnings has not shown what happened to the repaid funds. In particular, Bright Beginnings has not shown that it expended those funds for allowable Early Head Start operating purposes. *See Delta Found., Inc.*, DAB No. 1710, at 50 (1999), *aff’d*, *Delta Found. v. U.S.*, 303 F.3d 551 (5th Cir. 2002) (rejecting argument that ACF’s disallowance of funds grantee used to obtain unauthorized loans that were unrelated to the grant project should be reversed because the grantee “offered no explanation, much less documentation, as to what it then did with the repaid amounts, i.e., whether they were subsequently used for grant purposes.”).

We thus reject Bright Beginnings’ suggestion that the alleged partial repayments provide a basis for reversing the disallowance.

Conclusion

For the reasons stated above, we uphold the \$126,398 disallowance taken by ACF.

_____/s/
Constance B. Tobias

_____/s/
Susan S. Yim

_____/s/
Sheila Ann Hegy
Presiding Board Member