

**Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division**

Mental Health Association of Oregon
Docket No. A-14-43
Decision No. 2590
September 5, 2014

DECISION

The Mental Health Association of Oregon (MHAO) appealed the determination of the Substance Abuse and Mental Health Services Administration (SAMHSA) disallowing \$38,000 under two SAMHSA grants for compensation for three salaried MHAO employees for the period September 30 through December 31, 2011. SAMHSA determined that these costs were unallowable on the ground that MHAO did not have “personnel activity reports” for these employees for that period, as required by the cost principles applicable to the grants.

Based on the record before us, we uphold the disallowance in part and reverse it in part for the reasons explained below.

Background

MHAO is a non-profit organization located in Portland, Oregon that received federal funds totalling \$537,647 for the year ended September 30, 2012. MHAO Ex. 2, at 5. The funds were awarded by SAMHSA for two discretionary project grants, one titled PeerLink Technical Assistance Center (PeerLink) and the other titled Project Open. *See, e.g., id.*; HRSA Ex. 1, at 1 (unnumbered); MHAO Br. dated 4/24/14, at 3. MHAO also received funds from non-federal sources, including a contract with Portland State University. *See, e.g.,* MHAO Ex. 8, at 1.

Pursuant to the Single Audit Act, an independent auditor conducted a comprehensive financial and compliance audit of MHAO’s programs for the year in question.¹ The audit report questioned the allowability of \$38,000 in costs based on the following audit finding:

¹ The Single Audit Act, 31 U.S.C. § 7501 *et seq.*, is made applicable to non-profit organizations by 45 C.F.R. § 74.26(a).

Criteria – the Organization’s grants with its federal funder require[] the Organization to follow federal cost circulars that require the Organization to use after-the-fact personnel activity reports (timesheets) to document time and effort spent on the grants.

Condition – We noted that for the first three months of the [budget] year, timesheets were not used by three salaried personnel. The personnel involved were compensated approximately \$38,000 during this time period. Much of the cost could reasonably have been allocated to the grants, as the Organization had no other significant funded projects at the time. However, due to the lack of documentation of time and effort, we question the costs during this time period.

MHAO Ex. 2, at 7.

The compensation for the three employees for each of the three months at issue was charged in part to the PeerLink grant and in part to the Project Open grant. In addition, each employee’s compensation for at least one of the three months was charged in part to one or more non-federal cost centers, although these charges constituted a relatively small part of their total compensation. MHAO Ex. 7, at 1 (identifying individuals as B.C., A.Z., and D.H.), 3-8 (Summary of Wages by CostDiv).

The HHS Office of Inspector General found that the audit met federal audit requirements and referred the findings and recommendations to SAMHSA for resolution. SAMHSA Ex. 2. SAMHSA disallowed the \$38,000 questioned by the audit, citing as authority for the disallowance the cost principles at 2 C.F.R. Part 230, App. B, ¶ 8.m.(2)-(3), and a special condition of the PeerLink grant award providing that the award is subject to the grant administration requirements at 45 C.F.R. Part 74, including section 74.27, which incorporates by reference OMB Circular A-122, Cost Principles for Non-Profit Organizations, codified at 2 C.F.R. Part 230 (2013).² SAMHSA letter dated 1/9/14, at 2 (unnumbered).

Paragraph 8.m. of 2 C.F.R. Part 230, Appendix B, states that the “distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph 8.m.(2) of this appendix, except when a substitute system has been approved in writing by the cognizant agency.” Subparagraph m.(2) provides:

² SAMHSA provided a copy of the Notice of Award (NoA) for the PeerLink grant for the budget period ending September 29, 2012. SAMHSA Ex. 1. There is no NoA in the record for the Project Open grant. In the absence of any argument by MHAO to the contrary, we assume that the NoA for that grant included the same special condition described above.

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. . . . Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an after-the-fact determination of the actual activity of each employee. Budget estimates (*i.e.*, estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

Thus, for salaries and wages to be allowable under an award, grantees must maintain personnel activity reports that reflect the distribution of activity of each employee whose compensation is charged, in whole or in part, directly to federal awards.³

Part 74 also requires more generally that a recipient of federal funds have a financial management system that provides “[r]ecords that identify adequately the source and application” of funds for grant activities. . . .” 45 C.F.R. § 74.21(b)(2). (The NoA for the PeerLink grant contains similar language in the “Standard Terms of Award.” SAMHSA Ex. 1, at 2 (unnumbered).) In addition, paragraph A.2.g. of Appendix A to Part 230 provides generally that costs must be reasonable, allocable to the award, and adequately documented.⁴ Based on these requirements, the Board has repeatedly held that a “grantee has the burden of documenting the existence and allowability of its expenditures of federal funds.” *Suitland Family & Life Dev. Corp.*, DAB No. 2326, at 2 (2010) (citation omitted). “Once a cost is questioned as lacking documentation, the grantee bears the burden to document, with records supported by source documentation, that the costs were actually incurred and represent allowable costs, allocable to the grant.” *Northstar Youth Servs., Inc.*, DAB No. 1884, at 5 (2003).

³ Although SAMHSA’s disallowance letter also cited subparagraph m.(3), SAMHSA does not rely on that provision in its briefing.

⁴ Paragraph A.4. of Appendix A to Part 230 states that a “cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.”

Discussion

1. MHAO submitted timesheets for D.H. for October and November 2011 that meet the requirements of 2 C.F.R. Part 230, Appendix B, paragraph 8.m.(2).

On appeal, MHAO takes the position that it had weekly timesheets for D.H., one of the three employees, for October and November 2011 that met the requirement of paragraph 8.m.(2). According to MHAO, it maintained timesheets for D.H. for these two months because during that time she was an hourly employee, not a salaried employee as the audit found. MHAO argues that the disallowance of \$7,628.01 in compensation for D.H. for October and November 2011 should therefore be reversed. MHAO Reply Br. dated 6/6/14, at 2-3, 5-6; MHAO Ex. 8, at 1.

The documents submitted by MHAO are screenshots from MHAO's payroll system for D.H. for each week in October and November 2011 that show, for each work day, the number of hours she worked on the PeerLink grant and the number of hours she worked on the Project Open grant. The words "Approved by BC" and a date appear at the end of each row showing the grant and the hours worked. MHAO Ex. 8, at 2-9. MHAO also provided a letter dated June 5, 2014 signed by A.Z. as Executive Director that states that B.C. was formerly MHAO's Executive Director. MHAO Ex. 7, at 1.

The screenshots clearly reflect D.H.'s actual activity on a day-by-day basis. However, SAMHSA maintains that the screenshots "do not satisfy all of the criteria for personnel activity reports" in paragraph 8.m.(2)(c). SAMHSA Sur-Reply Br. dated 6/20/14, at 3. That provision requires that personnel activity reports must be signed "by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee[.]" In SAMHSA's view, the requirement for a signature is not satisfied by the indication that B.C. approved payment for the hours shown. *Id.* SAMHSA also argues that MHAO "has not provided any objective evidence that [B.C.] had 'first hand knowledge of the activities performed by the employee'" and that MHAO "has not alleged, nor provided any evidence indicating, that [B.C.] was [D.H.]'s direct supervisor or that she otherwise occupied a position that enabled her to have 'first hand knowledge' of [D.H.]'s day-to-day activities." *Id.* at 4. SAMHSA continues, "In fact, it is exceedingly unlikely that [B.C.], Appellant's Executive Director during the relevant time period..., would have 'first hand knowledge of the activities performed by' a purportedly hourly employee such as [D.H.]." *Id.*

SAMHSA's arguments are not persuasive. SAMHSA does not point to anything in the regulation that would preclude treating a supervisor's electronic approval in a payroll system as a signature. Indeed, SAMHSA accepted MHAO's corrective action plan providing that for "non-exempt" (i.e., salaried) employees, the "Executive Director approves hours worked and leave taken in the electronic payroll system." SAMHSA Ex. 5, attachment to 12/17/13 letter. In addition, contrary to what SAMHSA argues, it is

reasonable to infer from the facts here that B.C. had first hand knowledge of D.H.'s activities. MHAO had only five employees (including B.C.) on its payroll during the period in question. *See, e.g.*, MHAO Ex. 7, at 3-6. The screenshots identify D.H. as the "project coordinator" for the PeerLink and Project Open grants. One could reasonably expect that the Executive Director of such a small organization would have direct knowledge of how the organization's project coordinator divided her time between the two SAMHSA grants that were the organization's major source of funding. Moreover, the NoA for the PeerLink grant for the budget period identifies B.C. as the project director. SAMHSA Ex. 1, at 1 (unnumbered). Thus, this is not a situation where the Executive Director was responsible only for the general administration of a large organization and had no programmatic role.

We note that SAMHSA questioned the authenticity of payroll system reports provided with MHAO's initial brief because MHAO did not provide the reports earlier and had initially concurred in the audit findings. SAMHSA Br. dated 5/23/14, at 11-12. We conclude that SAMHSA has not identified a sufficient basis for questioning the authenticity of any of the documents from the payroll system, including the screenshots. MHAO's Executive Director signed a letter stating that the payroll system reports "were generated from stored data from Pamiris, the payroll company utilized by MHAO during the period 10/1/11-12/31/11." MHAO Ex. 7, at 1. The documents on their face indicate that they are from a secure Pamiris website, and the payroll reports are in a copyrighted format that would not be easy to duplicate. *Id.* at 3-8; MHAO Ex. 8, at 2-13.

In addition, MHAO explained that the reports were "kept offsite for security purposes and were not readily available to the auditors at the time of the audit." MHAO Br. dated 4/24/14, at 3. SAMHSA responded that MHAO's claim that the records were "offsite" and "not readily available" is "dubious," given that the records were electronic records that were generated in January 2014. SAMSHA Br. dated 5/23/14, at 11-12. SAMHSA does not deny that MHAO used Pamiris for its payroll during the relevant period, however, nor allege that MHAO had direct access to the stored data during the audit, without having to go through Pamiris. In light of the internal indicia of authenticity and MHAO's explanations, we decline to infer merely because no payroll system reports were generated and provided during the audit or immediately thereafter that the payroll system documents submitted on appeal are not authentic.

Accordingly, we conclude that MHAO had timesheets that showed that \$7,628.01 in compensation for D.H. for October and November 2011 was for time spent on the SAMHSA grants.

2. The remaining documentation submitted by MHAO does not meet the requirements of 2 C.F.R. Part 230, Appendix B, paragraph 8.m.(2).

MHAO does not dispute that it did not have timesheets for D.H. for December 2011 or for B.C. or A.Z. for the period September 1 through December 31, 2011. MHAO nevertheless argues that it complied with the requirements of paragraph 8.m.(2) because its electronic payroll system allocated costs “based on the employee’s time spent on the particular activity” and “required a supervisor’s authorization and approval of cost allocation before payroll could be generated.” MHAO Br. dated 4/24/14, at 3 (emphasis in original), citing MHAO Ex. 6.⁵ According to MHAO, moreover, a “supervisor who would have direct knowledge of the employee’s activities” had to approve the cost allocation. *Id.*, see also MHAO Reply Br. dated 6/6/14, at 4, citing MHAO Ex. 9.

We conclude that the payroll reports and other documents related to B.C. and A.Z. for the three-month period and to D.H. for December 2011 do not satisfy the requirement in paragraph 8.m.(2) for personnel activity reports that “reflect an after-the-fact determination of the actual activity of each employee.” The payroll reports show the amounts of an employee’s monthly compensation charged to each of the two SAMHSA grants and to non-federal funding sources where applicable. MHAO Ex. 7, at 3-6. While MHAO alleges that the charges were “based on the employee’s time spent on the particular activity,” MHAO cites to nothing in the payroll reports that documents the amount or the percentage of total time each employee spent on each activity. Instead, MHAO appears to rely only on an undated payroll system document titled “Cost Allocations” that shows the following allocation of costs for A.Z. (but no allocation for either of the other two employees at issue): 75% to PeerLink, 10% to Health Reform, and 15% to Administrative. MHAO Ex. 9. A note on the allocation report indicates that some allocations have been ended and contains the following direction: “Mouse over an allocation to see it’s [sic] effective range.” *Id.* However, there is no screenshot or other indication in the record of the time period for which these percentages were determined or how they were determined. In addition, these percentages are inconsistent with how the payroll reports show A.Z.’s compensation was charged for the three months at issue. Those reports show charges for A.Z. to PeerLink, Project Open, and “Portland State: EPM” for October and November, 2011 (at 50%, 25%, and 25% of her total compensation, respectively) and charges to PeerLink, Project Open, and “Alternatives” for her in varying percentages for December 2011. MHAO Ex. 7, at 3-6.

⁵ The names of the employees in MHAO Exhibit 6 are redacted. There are similar, unredacted documents in MHAO Exhibit 7.

Accordingly, we conclude that, except with respect to the compensation for D.H. for October and November 2011, MHAO failed to produce any evidence that provides the requisite assurance that the charges to the SAMHSA grants for the three employees accurately reflect the amount of time they actually spent on those grants.

3. The documentation provided by MHAO shows that the disallowance incorrectly includes \$2,422.91 charged to non-federal funds for A.Z. and that the disallowance was otherwise miscalculated.

MHAO argues that part of A.Z.'s salary—\$2,422.91—was improperly disallowed because it was paid by non-federal funds and not by SAMHSA funding. MHAO Reply Br. dated 6/6/14, at 2, 3, 5; MHAO Ex. 8, at 1. MHAO alleges, and the record shows, that \$1,130.72 for October 2011 and \$1,292.19 for November 2011 was charged to its contract with Portland State University for the Employment Peer Mentor (EPM) project. MHAO Exs. 8, at 1; 7, at 3-4. MHAO further alleges that “[t]hese funds were incorrectly attributed to SAMHSA funded salary by the auditors.” MHAO Ex. 8, at 1, citing SAMHSA Ex. 7, at 3-4.

Although SAMHSA does not dispute that \$2,422.91 of A.Z.'s compensation was paid by non-federal funds, SAMHSA argues that MHAO has not shown that “any non-SAMHSA funds were included in the auditor’s calculation of questioned costs or SAMHSA’s disallowance.” SAMHSA Sur-Reply Br. dated 6/20/14, at 6. Contrary to what SAMHSA suggests, however, SAMHSA, not MHAO, bears the responsibility for showing how the disallowance was calculated. *See* 45 C.F.R. § 74.90(c) (requiring that an agency final decision to disallow funds contain a “complete statement of the background and basis of the awarding agency’s decision” and “[e]nough information to enable the recipient to understand the issues and the position of the HHS awarding agency”).

In any event, the payroll reports submitted by MHAO show how the auditor calculated the “approximately \$38,000” of questioned costs. The total compensation for September through December 2011 for the three employees the audit identified as salaried employees was \$38,060.25. MHAO Ex. 6, at 11; *see also* MHAO Ex. 7, at 3-7.⁶ Furthermore, both the audit report and SAMHSA’s disallowance letter state that the three employees were “compensated” \$38,000 for this period. MHAO Ex. 2, at 7; SAMHSA letter dated 1/9/14, at 1 (unnumbered). Neither the audit report nor the disallowance

⁶ The compensation consists of the total wages plus benefits for the three employees shown in the column “Cost.”

letter described the \$38,000 as the amount charged to the SAMHSA grants. Accordingly, we find that the amount disallowed by SAMHSA includes \$2,422.91 of A.Z.'s compensation for October and November 2011 that was charged to the Portland State University contract, not to the SAMHSA grants.

The auditors also miscalculated the questioned costs by including amounts charged to other non-federal cost centers. As stated above, under the cost principles, salaries and wages must be supported by personnel activity reports that reflect the distribution of activity of each employee whose compensation is charged, in whole or in part, directly to federal awards. In the absence of such personnel activity reports, salaries and wages charged to a federal award are not allowable. Here, MHAO's payroll reports show that MHAO charged the two SAMHSA grants for compensation for the three salaried employees totaling \$33,713.76. MHAO Ex. 7, at 7. If, as the audit found, none of the amounts charged to these grants were supported by personnel activity reports, that amount, not the \$38,060.25 in total compensation for the three salaried employees, would have been correctly disallowed. However, we concluded above that \$7,628.01 in compensation for D.H. for October and November 2011 is allowable. Thus, the amount of unallowable costs is \$26,085.75 (i.e., \$33,713.67 minus \$7,628.01).⁷

SAMHSA nevertheless appears to argue that a \$38,000 disallowance is justified even if \$7,628.01 in compensation for D.H. for October and November 2011 is allowable and \$2,422.91 of A.Z.'s salary charged to the Portland State University contract was mistakenly included in calculating the disallowance. According to SAMHSA, the payroll reports show that the "total cost of wages for SAMHSA funded activities" for all five MHAO employees, including hourly employees M.C. and D.M., is approximately \$48,031, and MHAO "has failed to provide personnel activity reports for any of [these] employees." SAMHSA Sur-Reply Br. dated 6/20/14, at 7. Since the audit did not question any compensation for the hourly, non-salaried employees M.C. and D.M., and SAMHSA never stated that it was disallowing any such compensation, however, there was no reason for MHAO to provide personnel activity reports for these two employees, either in response to the audit or on appeal.

⁷ We note that \$1,951.13 of the compensation for B.C. for December 2011 was charged to the "Administrative" cost center, rather than being directly charged to any of MHAO's projects. MHAO Ex. 7, at 5. It appears from the NoA for the second budget period of the PeerLink grant that MHAO did not have an indirect cost rate. SAMHSA Ex. 1, at 1 (unnumbered) (showing an indirect cost rate of ".00 %"). Thus, it does not appear that any of the \$1,951.13 of "Administrative" costs was charged to the PeerLink or Project Open grants.

4. MHAO's other arguments do not provide a basis for reversing the remaining disallowance.

MHAO argues that the disallowance is excessive under the circumstances of this case. MHAO points to “very favorable statements” in the audit report, including that the auditors “did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses” or any “instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.” MHAO Br. dated 4/24/14, at 4. MHAO also points out that in a letter written after SAMHSA issued the disallowance, the auditor noted that MHAO had “self-detected, and self-corrected” the problem that led to the disallowance and that the auditor characterized the disallowance “as a very harsh sanction[.]” *Id.*; MHAO Ex. 5. In addition, MHAO notes that most of its funding during the audit period came from SAMHSA, so that “the hours were all or nearly all dedicated to the activities covered by the grant.” MHAO Br. dated 4/24/14, at 4. MHAO also asserts that it “has at all times operated in good faith[.]” *Id.* at 5. Further, MHAO argues that since it “has very little in unrestricted funds,” any “penalty... should be no more than about \$5,000.00 so that MHAO might be able to pay it.” *Id.* Finally, MHAO argues that it would be contrary to SAMHSA’s mission to pursue a disallowance “that could result in restrictions on MHAO and limitations on the services it can provide.” MHAO Sur-Reply Br., dated 8/14/14, at 4.⁸

None of these arguments provide a basis for reversing the remaining disallowance. That disallowance is not a discretionary sanction or penalty, but a determination that MHAO did not meet the terms and conditions of its SAMHSA grants with respect to specific cost items MHAO sought to charge to those grants. The Board has no authority to waive a disallowance on the basis of equitable principles. 45 C.F.R. § 16.14; *see, e.g., Depression and Bipolar Support Alliance*, DAB No. 2444, at 12 (2012). Moreover, the Board has specifically stated that it may not grant equitable relief on the basis that a grantee has taken corrective action, or that the disallowance may have a significant financial impact on a grantee’s organization. *Id.*

⁸ MHAO also asserts that this and other arguments constitute “compelling reasons” for the Board to “exercise its authority to order this matter to mediation.” MHAO Sur-Reply Br. dated 8/14/14, at 3, citing 45 C.F.R. § 16.18(a). Contrary to what MHAO suggests, the Board may not order a party to engage in mediation. Section 16.18(a) states in pertinent part, “If the Board decides that mediation would be useful to resolve a dispute, the Board, in consultation with the parties, may suggest use of mediation techniques and will provide or assist in providing a mediator.” As the Appellate Division Practice Manual (accessible at <http://www.hhs.gov/dab/divisions/appellate/practicemanual/manual.html>) points out, mediation requires the consent of both parties. Here, the Board has determined, based on the positions SAMHSA took in its briefing, that SAMHSA would not likely consent to mediation.

However, we note that the audit report states that “audit tests did not indicate additional timesheet issues occurring subsequent to the first three months of the year.” MHAO Ex. 2, at 7. Moreover, SAMHSA does not deny that the employees in question spent some part of their time on SAMHSA awards during three months covered by the disallowance. It is possible that, based on the timesheets that existed for the remaining nine months of the budget period, MHAO might be able to reasonably estimate the time each of the three employees spent on each activity during the three months at issue. The Board has stated that this procedure, known as “backcasting,” may be appropriate where a sample period is contiguous in time to the claim period (as it is here) and if it can be established that the circumstances in the sampled period are not substantially different from those in the claim period. *See, e.g., California Dep’t of Health Servs., DAB No. 1606, at 10 (1996) (citing cases).* MHAO provided no evidence based on which we could apply such an analysis here, but our decision does not preclude SAMHSA from further reducing the disallowance should MHAO provide such an estimate with supporting documentation.

Conclusion

For the foregoing reasons, we uphold the disallowance in the amount of \$26,085.75 and reverse the remaining disallowance of \$11,914.25.

_____/s/
Stephen M. Godek

_____/s/
Leslie A. Sussan

_____/s/
Judith A. Ballard
Presiding Board Member