

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Departmental Appeals Board

Civil Remedies Division

In the Case of:)	
)	
New World Christian)	DATE: JUL 21, 1989
Ministries,)	
)	
Petitioner,)	
)	
- v. -)	Docket No. C-78
)	
Office of Human Development)	DECISION CR 34
Services.)	
)	

DECISION

The Petitioner, New World Christian Ministries (NWCM), requested a hearing to contest the determination made by the Office of Human Development Services (OHDS) to deny refunding of the Petitioner's federally funded Head Start program in 1989.¹ This determination was made by the Regional Administrator for OHDS, Region V, in a letter to NWCM dated December 2, 1988, and was based upon, inter alia, the Petitioner's failure to correct a series of deficiencies. OHDS Ex 30.² A hearing was held before

¹ Pursuant to 45 C.F.R. 1303.25(f), the denial of NWCM's refunding, which was to begin on January 1, 1989, is being held in abeyance until the issuance of a final decision on NWCM's application for refunding its Chicago based Head Start program. See OHDS Ex 21/289; OHDS Ex 30.

² The citations to the record in this Decision are noted as follows:

Transcript of March 21, 1989	TR I/(page)
Transcript of March 22, 1989	TR II/(page)
Transcript of March 23, 1989	TR III/(page)

(continued...)

this Administrative Law Judge (ALJ) on March 21, 22, and 23, 1989, in Chicago, Illinois.

Based on the record developed at the hearing, the parties' post-hearing briefs, and the applicable law and regulations, I hereby conclude that OHDS's determination to deny refunding of the direct grant is fully and substantially supported by the evidence. My decision, the "initial decision" under 45 C.F.R. 1303.25, upholds the Regional Administrator's determination.^{3 4}

APPLICABLE LAW AND REGULATIONS

The federally funded Head Start program was established by the Economic Opportunity Act of 1964. Pub. L. 88-452, Title II, section 222(a)(1); 42 U.S.C. 2809(a)(1) (1970); OHDS Memo 1, for 1. In recognition of the program's effectiveness in serving economically disadvantaged children and their families, a subchapter cited as the "Head Start Act" was enacted by Public Law 97-35 on August 13, 1981. The current statutory authority for the

<p style="text-align: center;">² (...continued)</p>	
Petitioner's Posthearing Brief	Pet. Br (page)
Petitioner's Exhibit	Pet. Ex (number)/(page)
OHDS Posthearing Brief	OHDS Br (page)
OHDS January 29, 1989 Memorandum	OHDS Memo (page)
OHDS Exhibit	OHDS Ex (number)/(page)

³ This Decision is submitted to OHDS and mailed to the parties pursuant to Part 1303 of the Department's Rules and Regulations (45 C.F.R. 1303). Subsection 1303.36 provides, in pertinent part, "Any party may, within 20 days of mailing such INITIAL DECISION . . . , file with the responsible HHS official his exceptions to the INITIAL DECISION and any supporting brief or statement."

⁴ NWCM has many fine and compassionate people in its organization who are committed to disadvantaged children and their families. However, OHDS' determination is supported beyond a reasonable doubt by the record; OHDS was very lenient with NWCM and had no other choice under the circumstances.

program is found at 42 U.S.C. 9831 et seq. (1976) (Supp. V 1981), and 42 U.S.C. 9834 (Supp. 1988) (extending funding for Head Start through 1990).

Department regulations governing the administration of the Head Start program are found at 45 C.F.R. Part 1301-1305. Regulations providing "program performance standards" for Head Start grantees are contained in 45 C.F.R. Part 1304. Fiscal requirements for Head Start grants are found at 45 C.F.R. Part 74, the general Department regulations governing "Administration of Grants." In this Decision, I set out each of the relevant fiscal and program requirements as I discuss their significance in the context of this case.

The rules governing this hearing and decision are found at 45 C.F.R. 1303.20 - 1303.26 and at 45 C.F.R. 1303.35. The burdens of justification and proof are found at 45 C.F.R. 1303.22.

BACKGROUND

The national Head Start program is administered by OHDS, a component of the United States Department of Health and Human Services (DHHS).⁵ The Head Start program's purpose is the effective delivery of comprehensive health, educational, nutritional, social, and other services to economically disadvantaged children and their families. OHDS Br 1.

Under the Head Start Act, OHDS, as a delegate of the DHHS Secretary, is authorized to provide financial assistance, upon proper application, to a qualified local public, or private, nonprofit agency for planning, conducting, administering and evaluating a Head Start program. Among the criteria, a "qualified" Head Start agency must be determined by the Secretary to be capable of such functions. The Act provides, however, that financial assistance shall not be withheld from a recipient agency for failure to comply with terms and conditions unless the agency has been given reasonable notice and the opportunity to show cause why such action should not be taken. The Secretary also has authority to issue regulations and other guidance for program administration and grant management.

⁵ OHDS administers, or is in charge of, several sub-organizations, such as the Head Start Bureau, the Administration for Children, Youth and Families (ACYF), and the Office of Community Programs. In this Decision, OHDS is used also to designate these sub-organizations.

The actual conduct of a Head Start program is the responsibility of the local agency grantee. Each grantee is expected to comply with all relevant laws, regulations, instructions, guidelines, performance standards, as well as terms and conditions of the grant. OHDS instructions are issued in correspondence to grantees and in official documents. Terms and conditions of grants are contained or referenced in the grant documents. All of these are promulgated to local grantees.

All grantees must hire qualified personnel who must use grant funds effectively. Adequate financial management systems must be implemented and maintained, with effective internal controls.

If a grantee fails to abide by these requirements, or does not maintain required legal status or financial viability, the administrative office which makes the grant is responsible for taking termination action.

ISSUES

The issues in this case are:

1. Whether OHDS established that NWCM failed to comply with fiscal and program requirements, and with the terms of its grant, as set forth by OHDS in its December 2, 1989 letter to NWCM.
2. Whether NWCM submitted an inadequate application for continued funding (refunding application).

FINDINGS OF FACT AND CONCLUSIONS OF LAW ⁶

Having considered the entire record, the arguments and submissions of the parties, and being fully advised herein, I make the following Findings of Fact and Conclusions of Law:

1. NWCM is a nonprofit social service organization which has operated a Head Start program in Chicago, Illinois since approximately 1979. TR I/99.
2. From 1979 until 1984, NWCM's Head Start program was funded entirely on a sub-contract basis, or under a

⁶ Any other part of this Decision which is obviously a finding of fact or conclusion of law is incorporated herein.

"delegate contract," with the City of Chicago. TR I/100; TR III/7.

3. A "delegate agency" includes a public or private non-profit organization or agency to which a grantee has delegated all or part of its responsibility for operating a Head Start program. 45 C.F.R. 1301.2.

4. A "Head Start Agency" or "grantee" is a local public or private non-profit agency designated to operate a Head Start program by the responsible DHHS official, pursuant to 45 C.F.R. 1302. 45 C.F.R. 1301.2.

5. NWCM became a direct grantee on July 1, 1984, when it was awarded a direct grant for a Head Start program by OHDS. TR I/92; TR III/6-7.

6. At the time NWCM became a grantee, it continued operating a separate and distinct Head Start program as a delegate agency of the City of Chicago. TR III/7.

7. Pursuant to DHHS regulations, NWCM retained Adler & Associates, Certified Public Accountants, to audit and prepare a financial report on NWCM Grant No. 05CH5232 as of December 31, 1986.

8. On April 10, 1987, Adler & Associates issued its Financial Report of examination of the NWCM balance sheet and the related statements of revenue, expenditures and changes in fund balance (deficit) and changes in financial position for the calendar year. OHDS Ex 33.

9. Adler & Associates determined that NWCM is primarily dependent upon grants from governmental agencies, with a secondary dependency on public contributions. Adler & Associates concluded that NWCM's financial support had been inadequate to cover the net NWCM costs, resulting in an accumulated deficit in excess of \$625,000 on December 31, 1986. Id.; OHDS Ex 34; TR I/29; TR III/80.

10. NWCM's chief fiscal officer, Luther Hinton, acknowledged that he believed the Adler & Associates audited deficit of \$625,000 to accurately reflect NWCM's corporate deficit. TR I/129.

11. The Adler & Associates audit was rejected by the Region V Inspector General for Audit, DHHS, due to non-conformity with federal audit standards. P Ex 5.

12. In 1987, the City of Chicago conducted an internal review of NWCM's delegate Head Start program. This investigation revealed that approximately \$250,000 in

undisbursed payroll checks for delegate program employees had been stored in an NWCM safe, although the City of Chicago had funded NWCM for those payroll expenses. TR I/124; TR III/72-74.

13. As a result of the Adler & Associates audit and the City of Chicago internal review, DHHS and the City of Chicago jointly decided to retain Washington, Pittman & McKeever, Certified Public Accountants (WPM) to perform an independent certified audit of NWCM. TR III/76-78.

14. OHDS notified NWCM of this decision on June 18, 1987, pointing out the OHDS was "concerned about the safety and proper usage of Head Start funds, particularly in view of the large amount of such funds flowing through your agency (\$1,279,003)." NWCM was further told that the scope of the WPM audit would include NWCM's entire agency, concentrating on its Head Start operations as both a delegate and as a grantee. P Ex 5.

15. The WPM audit of NWCM for the period December 1, 1985 to November 30, 1986 reflected that NWCM had a corporate deficit of \$649,388. OHDS Ex 1/4,6.

16. In its audit report for the period December 1, 1985 through November 30, 1986, WPM determined that the corporate deficit of \$649,388, the net loss of \$102,315 for 1986, and an Internal Revenue Service (IRS) tax liability of \$131,838, as well as NWCM's substantial reliance on reimbursable cost basis contracts with federal, state and local government agencies for its programs, "indicate that the agency (NWCM) may be unable to continue in existence." OHDS Ex 1/4,12.

17. NWCM's chief fiscal officer conceded that the debt to the IRS was of a short-term nature which could "threaten the existence" of NWCM. TR I/132.

18. WPM further found that, as of November 30, 1986, NWCM regularly submitted claims and received reimbursement for operating and payroll expenses before such expenses were actually paid; that NWCM made payments of those amounts as late as 90 days after reimbursement was received; that NWCM failed to pay its employees on regularly scheduled pay dates; and that NWCM had various accounting problems. OHDS Ex 1/16-25.

19. WPM also performed an agency-wide audit of NWCM for the period December 1, 1986 through May 31, 1987, which reflected that NWCM's corporate deficit had grown to 799,707, including a net loss of \$141,503 for the six-month period ending May 31, 1987. OHDS Ex 2/64, 66.

20. WPM concluded that NWCM's six-month net loss of \$141,503, its corporate deficit of \$799,707 and its IRS tax liability of \$131,838, indicated that "the agency may be unable to continue in existence." OHDS Ex 2/64, 71.

21. On October 20, 1987, NWCM filed its application with OHDS for continued funding of its Head Start program for fiscal year 1988. OHDS Ex 4.

22. On December 11, 1987, the Regional Administrator of OHDS designated NWCM a "high risk organization" because of a continuing corporate deficit and other deficiencies. A "high risk organization" is an organization whose management practices create relatively high risks of poor programmatic use and financial stewardship of grant funds. OHDS Ex 5.

23. In its December 11, 1987 correspondence, OHDS relied on the Adler & Associates audit, which disclosed a \$625,373 corporate deficit, and that the WPM audits reflected a deficit of \$799,707 as of May 31, 1987, which was an increase of \$150,319 since November 30, 1986. OHDS concluded this was "evidence of serious deficiencies in your program or business management practices." OHDS Ex 5.

24. OHDS placed NWCM on a cost reimbursement payment system effective January 1, 1988, and noted that NWCM's failure to comply with the requirements of 45 C.F.R. Part 74 would be grounds for the immediate suspension of its Head Start direct grant pursuant to 45 C.F.R. 74.114. OHDS Ex 5.

25. In a letter to NWCM dated December 22, 1987, the Regional Administrator of OHDS determined to conditionally fund NWCM for its Head Start direct grant during the period January 1, 1988 through December 31, 1988. NWCM was requested to correct deficiencies set forth in that letter by March 31, 1988. OHDS Ex 7.

26. Also in that letter of December 22, 1987, OHDS instructed NWCM to provide a detailed report by January 29, 1988 on its progress in correcting the nine categories of deficiencies outlined. OHDS Ex 7.

27. The December 22, 1987 letter warned NWCM that failure to correct such deficiencies could constitute grounds for termination of its direct grant. OHDS Ex 7.

28. On December 28, 1987, NWCM requested technical assistance from OHDS to "reconcile" its records with that of the WPM audits for the periods ending November 30,

1986 and May 31, 1987, and to change its designation as a "high risk organization." OHDS Ex 6.

29. OHDS personnel conducted an on-site review at NWCM on February 9-12, 1988. OHDS provided detailed technical assistance to correct program deficiencies, and transmitted a ten-page "report of findings" from the on-site review to NWCM on March 25, 1988. OHDS also instructed NWCM to submit a Grantee Improvement Plan by May 25, 1988, and to achieve full compliance by June 25, 1988. OHDS Ex 10.

30. On February 17, 1988, NWCM assured the Regional Administrator of OHDS that it would "take steps to address the fiscal and management deficiencies" outlined in the audit findings and the Regional Administrator's December 22, 1987 letter. OHDS Ex 8.

31. The February 17, 1988 letter enclosed a "deficit reduction plan," which included a specified deadline for correcting each of the deficiencies noted by the Regional Administrator and the WPM audits. OHDS Ex 8.

32. The first described deadline in the NWCM deficit reduction plan was to "settle" or otherwise liquidate NWCM's tax debt of \$131,838 by December 30, 1988. OHDS Ex 8.

33. The NWCM deficit reduction plan outlined in the February 17, 1988 letter proposed a deficit reduction schedule that included a projected salary contribution of \$60,000 from NWCM's employees, a projected income of \$20,000 from an Annual Recognition Banquet, a projected income of \$25,000 from Community Advisory Board fund raising efforts, and contributions totalling \$115,000 during 1987 and 1988 from supporting organizations. OHDS Ex 8.

34. NWCM never established the Community Advisory Boards which it had planned to create as part of the deficit reduction plan submitted to OHDS. TR I/76.

35. NWCM never held an Annual Recognition Banquet. TR I/150.

36. NWCM currently owes the IRS approximately \$250,000. TRI/132.

37. The IRS has placed a lien on NWCM property. TRI/132.

38. The large IRS debt seriously threatens NWCM's existence. TR I/132.

39. NWCM's deficit reduction plan "just did not work out," according to its chief fiscal officer. TR I/81-82.

40. The only credible evidence that any of the financial contributions and goals of NWCM's deficit reduction plans were met was a \$41,434.39 donation from Douglass/Tubman Youth Ministries. OHDS Ex 8; TR I/76, 150, 152; TR III/88-90, 96.

41. The Grantee Improvement Plan required by OHDS was for a reasonable, well documented, specific deficit reduction plan with definite dates for specific fund raising events. TR III/84-89. The NWCM deficit reduction plan and schedule set forth in its letter of February 28, 1988 (OHDS Ex 8) lacked credibility and was not acceptable to OHDS. TR III/84-89.

42. NWCM wrote to OHDS on March 28, 1988, outlining a number of "significant milestones" that had been achieved in complying with the Regional Administrator's letter of December 22, 1987. NWCM stated that past salary liabilities had been reduced by \$80,000, that internal management systems had been strengthened, and that discussions continued with the IRS regarding NWCM's tax liability. OHDS Ex 11.

43. On April 13, 1988, OHDS corresponded with NWCM and reviewed the NWCM submissions of February 17 and March 28, 1988 (outlining the action taken by NWCM to correct the deficiencies cited by OHDS in its December 22, 1987 "special condition" letter). OHDS concluded that the NWCM corrective action plan failed to sufficiently describe the progress made, and that it did not provide adequate information for a full evaluation. OHDS Ex 12.

44. The April 13, 1988 letter from OHDS further advised NWCM that its deficit reduction schedule failed to address the requirement that the plan provide documentation of measurable events and dates by which the deficit would be reduced. OHDS Ex 12.

43. OHDS further instructed NWCM to provide the basis of its projections for net income from its fund raising activities. OHDS Ex 12.

45. Also, in the April 13, 1988 letter, OHDS expressed concern to NWCM regarding the nature and status of negotiations with the IRS concerning the high tax delinquency and requested that the results be immediately reported to OHDS. OHDS Ex 12.

46. The April 13, 1988 letter further advised NWCM that it had failed to address the impact which its deficit had or might have on the OHDS grant, and that NWCM had not specified the safeguards which NWCM would take to insulate the OHDS grant from any future impact. OHDS Ex 12.

47. OHDS extended the date by which NWCM must take corrective measures from March 31, 1988 to May 31, 1988, in "order to allow NWCM an opportunity to thoroughly address these issues and avail itself of the technical assistance being provided by CSR, Inc. in the areas of fund raising, management organization, budgeting and cost allocation." OHDS Ex 12.

48. On May 13, 1988, at the request of NWCM, OHDS extended the due date to June 30, 1988 for the audit of the program year ending December 31, 1987. OHDS Ex 13.

49. NWCM's only attempt to document its claim that salary liability had been reduced by \$80,000 was a list of employees and their alleged contributions set out in a letter to OHDS dated May 28, 1988. No supporting documentation was produced to substantiate this assertion. OHDS Exs. 11, 15.

50. In a letter dated May 28, 1988, NWCM set forth its efforts and plans for correcting the deficiencies previously noted by OHDS. OHDS Ex 15.

51. The May 28, 1988 letter outlined projected revenue of \$50,000 from a gospel concert planned for December 1988, but NWCM never raised any funds from the concert. OHDS Ex 15; TR I/152.

52. On June 23, 1988, NWCM corresponded with OHDS concerning the on-site followup review conducted February 9-12, 1988. OHDS Ex 16.

53. On July 22, 1988, OHDS provided the application forms necessary for refunding Head Start Grant 05CH5232 for fiscal year 1989. In that letter, OHDS noted that it had not received an acceptable annual audit for the Head Start program for the year ended December 31, 1987, and that "(f)ailure to submit acceptable audits on a timely basis, will result in your agency being put in High Risk status and the possibility of losing the Head Start granteeship." OHDS Ex 17.

54. On September 28, 1988, NWCM corresponded with OHDS concerning its inability to obtain an independent certified audit for the program year ended December 31,

1987 because the Department of Human Services of the City of Chicago (DHS Chicago) had refused to pay "its fair share" of the cost of the audit. NWCM accused DHS Chicago of "unethical practices...to effectuate the ruination of NWCM, a competing Head Start grantee." OHDS Ex 18.

55. On October 6, 1988, OHDS notified NWCM that its Head Start application was due by October 3, 1988 and had not been received. NWCM was informed that it was in violation of OHDS requirements, and that because of NWCM's noncompliance, timely release of Head Start grant funds could not be guaranteed. OHDS Ex 19.

56. In a letter dated October 6, 1988, NWCM requested an extension of the deadline for filing its grant application until October 12, 1988. OHDS Ex 20.

57. NWCM's Head Start grant application number 05CH5232, for fiscal year 1989, was received by OHDS on October 12, 1988. TR III/17, OHDS Ex 21.

58. On October 20, 1988, OHDS corresponded with NWCM, concerning its September 28, 1988 letter about the status of the audits for the periods ending December 31, 1987 and September 15, 1988. OHDS pointed out that NWCM's failure to begin the required audit five months after it was originally due required OHDS to consider the alternatives available under 45 C.F.R. 1303, Subpart D. OHDS Ex 22.

59. In another letter to NWCM on October 20, 1988, OHDS notified NWCM that an on-site review would be conducted on October 26-27, 1988 to focus on the issues of NWCM's problems in achieving full enrollment; to follow up on the issues raised during the February 9-12 on-site review; to follow up on the various fiscal and administrative problems set out in the OHDS letter of December 22, 1987; and to consider NWCM's grant application for fiscal year 1989. OHDS Ex 23.

60. On October 21, 1988, OHDS corresponded with NWCM concerning the fiscal year 1989 grant application which had been submitted on October 12, 1988, nine days beyond the deadline. OHDS indicated an informal review of the application revealed it to be unacceptable for formal processing and review, and rejected the tendered application. OHDS instructed NWCM that in order for it to be considered for funding of a Head Start program during fiscal year 1989, NWCM would have to submit an acceptable application no later than November 4, 1989,

and stressed the importance of a timely submission. OHDS Ex 24.

60. OHDS identified several major inadequacies of the October 12, 1988 application, including concern about the parental involvement in the program's decision-making process; the inadequacy of the non-Federal resource section; unexplained increases and changes in staffing time; and failure to address NWCM's fiscal and administrative problems. OHDS Ex 24.

61. On October 26-27, 1988, OHDS conducted an on-site review at NWCM. Darrell Nelson and Steve Krasner of OHDS reviewed records, interviewed NWCM personnel, and provided technical assistance, including instructions about the inadequacies of the 1989 refunding application submitted October 12. TR III/96.

62. On November 2, 1988, OHDS summarized the findings of the October 26-27 on-site review, and advised NWCM that all concerns raised by OHDS in its October 21, 1988 letter (OHDS Ex 24) had to be adequately addressed in the 1989 refunding application. OHDS Ex 25.

63. In the November 2, 1988 letter, OHDS questioned NWCM's ability to generate the non-federal share which NWCM estimated in its refunding application, and OHDS stated that there was an apparent shortfall in the required non-Federal share. OHDS also reiterated its concern that the refunding application failed to adequately consider the 15 percent limitation on administration and development costs, and further advised NWCM that its program audit for the period ending December 31, 1987 was substantially delinquent. OHDS Ex 25.

64. The OHDS November 2, 1988 letter also noted that NWCM's corporate deficit appeared unchanged from the beginning of the year, since NWCM had produced accounting records reflecting an agency deficit of \$564,986.48 as of January 1, 1988, subject to audit. OHDS Ex 25.

65. OHDS also expressed concern that NWCM had postponed or abandoned most of its fund raising projects, and that NWCM had failed to present documentation which showed progress or resolution of its continuing indebtedness. OHDS Ex 25.

66. During 1988, NWCM received approximately 210 hours in technical assistance from CSR, Inc. for management, program and fiscal problems. This assistance was

provided at no cost to NWCM and was in addition to its financial assistance award. TR III/14-16; OHDS Ex 9.

67. NWCM resubmitted its application on November 4, 1988, which OHDS still found to be unacceptable. OHDS Ex 28; TR III/18.

68. NWCM has failed to submit a satisfactory refunding application for fiscal year 1989. The application resubmitted on November 4, 1989 contained major deficiencies in planning, budgeting and staffing. TR III/18.

69. On November 25, 1988, OHDS acknowledged receipt of correspondence from NWCM dated November 14, 1988 (OHDS Ex 26) which "strongly disagreed" with OHDS' findings from the on-site review. OHDS advised NWCM that it had "not provided [to OHDS] any information which would serve as a basis for altering the findings." OHDS Ex 29.

70. OHDS informed NWCM on December 2, 1988 that its refunding application for its direct grant for the fiscal year 1989 was being denied "due to NWCM's failure to comply with the terms and conditions of its grant and applicable regulations in 45 C.F.R. Part 74 and 45 C.F.R. Part 1301 et seq." OHDS Ex 30.

71. OHDS has given NWCM adequate opportunity to satisfactorily explain its financial problems and resolve the questions surrounding its financial status, but it has not done so.

72. Both the October 12 and the November 4, 1988 refunding applications for fiscal year 1989 which NWCM submitted were deficient and unacceptable.

73. Federal regulations provide that "special grant conditions more restrictive than those prescribed in this Part 74 may be imposed as needed when the granting agency has determined that the grantee: (1) Is financially unstable, (2) Has a history of poor performance, or (3) Has a management system which does not meet the standards of this part." 45 C.F.R. 74.7(a).

74. Federal regulations require a grantee whose legal condition has changed or whose financial resources have been diminished to show satisfactorily that it has or will continue to have legal status and financial viability. 45 C.F.R. 1302.20.

75. NWCM did not show that it had acted effectively to reduce its deficit.

76. NWCM did not show that it had met the requirement to submit an audit for the year preceding the proposed refunding year.

77. NWCM did not show that it met the requirement for matching 25 percent of the federal funding or 20 percent of the total funding. 45 C.F.R. 1301.20.

78. NWCM did not show tht it had obtained the required Parent Policy Council approval to apply for refunding for 1989. 45 C.F.R. Part 1304, Appendix B; OHDS Ex 24.

79. NWCM did not demonstrate that it met the OHDS compliance standards in a timely manner in order to be restored refunding for its Head Start direct grant for 1989.

80. OHDS has supported by a preponderance of the evidence that its determination to deny NWCM refunding for its Head Start direct grant for 1989 was appropriate under federal law and regulations.

DISCUSSION

The Regional Administrator's December 2, 1988 determination to deny refunding of NWCM's Head Start direct grant was based upon a series of fiscal and programmatic deficiencies outlined in a document attached to the determination letter, which was headed "Grounds for Intent to Deny Refunding of NWCM." The record indicates that each of these deficiencies had been identified in previous correspondence with NWCM, and that OHDS personnel discussed the problems with NWCM personnel during the on-site visits of February 9-12 and October 26-27, 1988. NWCM's 1988 grant had been refunded by OHDS contingent upon its compliance with certain special conditions, which had been outlined to NWCM on December 22, 1987. NWCM was required to correct these same deficiencies by March 31, 1988 (later extended to May 31, 1988). OHDS found that NWCM had not corrected these deficiencies at the time the 1989 refunding application was submitted.

NWCM did not contend that the grounds cited by the Regional Administrator were an improper basis for denying refunding to a Head Start grantee. Neither did NWCM specifically refute most of the Regional Administrator's findings. Instead, NWCM sought to explain the circumstances of each of the alleged deficiencies, claiming that several of the deficiencies had arisen because of "unavoidable" problems which NWCM had with its entirely distinct Head Start delegate grant with the City

of Chicago. This "delegate contract" with the City (in effect a sub-grant) existed from 1979 until the City terminated it in mid-1988. NWCM argued that it had been a victim of a "vendetta" by the City because it was in direct competition with the City as a Head Start grantee with OHDS. This "vendetta" caused NWCM's substantial corporate deficit, it claimed, and consequently, also caused some of its other problems.

In order to ensure that NWCM received a full and fair hearing, I allowed it to present evidence concerning its problems with the City, over the objection of OHDS that these matters were irrelevant to questions concerning the direct grant with OHDS. I agree with OHDS, however, that it is not my role to evaluate the circumstances of the termination of the delegate contract with the City of Chicago. Moreover, in considering the evidence presented concerning its delegate contract, I do not find NWCM's purported problems with the City to excuse any of the deficiencies cited by the Regional Administrator.

In this Discussion, I first consider NWCM's specific allegations concerning its delegate contract with the City. I then address briefly each of the findings by the Regional Administrator cited as a basis for the nonrenewal determination in the December 2, 1988 OHDS determination letter.⁷

I. NWCM's Deficit.

A major basis for OHDS's determination to deny refunding was the continued existence of a large corporate deficit by NWCM, which the December 2, 1988 determination noted was \$799,707 as of May 31, 1987 (OHDS Ex 30) of a total NWCM budget as of May 31, 1987 of approximately \$1.5 million. TR I/129. One allegation by NWCM was that the size of this deficit was exaggerated by a "hostile audit" performed by WPM, an accounting firm that was jointly hired by OHDS and the City of Chicago to audit NWCM. TR 158. NWCM also alleged that the debt was attributable to unavoidable problems in its dealings with the City, as well as an outstanding debt by the City to NWCM.

⁷ After the Hearing in this case, NWCM added new counsel to assist NWCM in this case. NWCM's new counsel, in a footnote in her post-hearing submission, requested a chance to submit new evidence. OHDS objected. I find and conclude that this case has already been delayed long enough, NWCM has already been given ample opportunity to present all relevant evidence, and this case must come to a close. Accordingly, I deny the Petitioner's request.

NWCM attempted to impeach the reliability of the WPM audits. One witness, an employee of the City as well as a former NWCM employee, testified to her low opinion of the CPA firm. TR III/210, see also TR I/67. The accounting firm was used by the City to audit all their delegate contracts. NWCM itself hired another accounting firm for an independent audit for the same time as the WPM audit. OHDS Ex 31. As far as the deficit is concerned, I do not find any of the allegations concerning the WPM audit ultimately relevant, since NWCM's own audit, by Adler and Associates, also found a deficit of \$625,373 as of December 31, 1986. OHDS Ex 34. I find OHDS's concern about the financial viability of NWCM to be justified whether the amount of NWCM's deficit was found to be either \$799,707 or \$625,373.

NWCM maintained that the deficit was due in large part because of actions taken by the City to withhold certain "payment vouchers" to NWCM to which it allegedly was rightfully entitled. TR I/71. The NWCM chief fiscal officer testified that the City of Chicago was indebted to NWCM in the amount of approximately \$500,000. TR I/138. NWCM thus implied that its corporate deficit occurred because of circumstances beyond its control.

Even if I found this to be an accurate picture of the City's indebtedness to NWCM, I would not find this to be an adequate basis on which to question OHDS's findings concerning the debt. As OHDS repeatedly emphasized, NWCM's direct grant with OHDS was entirely separate from its delegate contract with the City. This is not the proper forum for NWCM to resolve its accounting dispute with the City of Chicago.

Furthermore, the record does not substantiate the allegation concerning this \$500,000 debt owed by the City to NWCM. None of the documentary exhibits refers to such a debt, nor do they support an inference that a debt of this size existed. Neither the Adler and Associates audit nor the WPM audits alluded to such an indebtedness. OHDS Ex 33, 34; OHDS Ex 1, 2. An NWCM witness did maintain that NWCM's reimbursement vouchers were "always late," but did not testify as to the size of any outstanding indebtedness. (TR III/200). Another witness, the trustee under the current arrangement between NWCM and the City, testified that the City may owe NWCM about \$6,000 related to tax payments. TR II/69. An accountant for the City government denied the existence of the \$500,000 debt, and stated that the City owes nothing to NWCM. TR III/154. A March 9, 1989 letter on City of Chicago stationery, drafted by the accountant, states that NWCM actually owes the City

\$78,871.41 for advances from the 1987 fiscal year. OHDS Ex 35, TR III/158-159.

I conclude that OHDS's finding concerning the substantial NWCM debt is substantiated by the record, and I am not convinced by NWCM's allegations that the debt was attributable to unavoidable problems with its delegate contract with the City.

II. Failure to comply with terms and conditions of the current grant award.

This ground, cited in the December 2, 1988 determination letter, relates essentially to the "special conditions" that were imposed on the continuation of the grant award for calendar year 1988. OHDS Ex 7. The Regional Administrator required NWCM, initially by March 31, 1988, to correct "extremely serious deficiencies" which she found. This deadline was later extended to May 31, 1988. Id.; OHDS Ex 12. The major deficiency cited was the large corporate deficit, which the Regional Administrator associated with a "threat of insolvency." OHDS Ex 7. The record amply demonstrates that NWCM has to date been unable to reduce the substantial deficit found by the auditors, and the record indicates that it has even continued to increase.

NWCM presented no evidence that the \$625,000 deficit found by the Adler and Associates audit has been reduced. NWCM conceded that it has not paid its debt to the IRS, and currently has an outstanding tax liability of over \$200,000. TR I/132. The IRS has placed a lien on NWCM's property because of the debt. TR I/92. OHDS's site visit to NWCM on October 26-27, 1988 confirmed the existence of the large deficit. OHDS Ex 25. OHDS's fiscal expert assigned to the NWCM grant testified that in his opinion, NWCM's current deficit was even greater than that found by the WPM audits. TR III/112.

NWCM submitted a deficit reduction plan as part of a February 17, 1988 submission to OHDS. OHDS Ex 8. The plan established a series of self-imposed deadlines, including as a first priority the dissolution of its tax liability to the Internal Revenue Service by December 30, 1988. An OHDS witness, the fiscal expert assigned to the NWCM grant, testified that the plan itself was unrealistic. TR III/86-87.

NWCM's deficit reduction plan listed various sources of revenue to reduce the deficit, including contributions of employee salaries, contributions from "supporting organizations," an "annual recognition banquet," and

other fund raising activities. However, NWCM's plans for fundraising activities were all aborted or were apparently unsuccessful. OHDS Ex 25, TR I/83-84.

One allegation by NWCM concerning its deficit was that it had been unable to absorb the effect of its loss of its delegate contract with the City of Chicago. However, NWCM did not articulate specifically why this was so, or what measures had been undertaken to reduce its deficit since the loss of the delegate contract on June 15, 1988. OHDS Ex 18. Its fiscal officer also alleged that one must examine the "composition of the debt," and that some of it was of a long-term nature that did not threaten the survival of the organization. TR I/130. However, NWCM presented no details of why some of the debt was of a long-term nature and presented no documentation at all concerning the state of the current debt. NWCM's witness acknowledged that more short-term debt could threaten the organization since it could force a bankruptcy (*id.*), and admitted under cross-examination that its tax debt was of such a short-term nature. TR I/132.

III. Failure to submit an audit for the period ending December 31, 1987.

The second ground for OHDS's nonrenewal determination was NWCM's failure to submit an audit for the 1987 program year, which OHDS described as a "serious impediment to OHDS's determination of the viability of NWCM's financial status." Determination letter/Att., p. 4. (OHDS Ex 30).

Under 45 C.F.R. 1301.12, Head Start programs must submit an audit for each budget period by an independent auditor to determine:

- A. whether the agency's financial statements are accurate;
- B. whether the agency is complying with the terms and conditions of the grant; and
- C. whether appropriate financial and administrative procedures and controls have been installed and are operating effectively.

45 C.F.R. 1301.12(a).

Subsection (c) provides that the program must submit such an audit within four months of the close of each budget period, or by April 30, 1988 for the 1987 program year, unless otherwise approved.

According to the December 2, 1988 determination letter, NWCM was granted an extension of 60 days, to June 30, 1988, to submit its budget. OHDS notified NWCM by letter of July 14, 1988 that the submission of the audit was delinquent. OHDS Ex 22. As of September 28, 1988, NWCM had still not submitted the audit, and wrote to the Regional Administrator to complain that the Chicago Department of Human Services "has refused to honor its fair share of \$10,000.00 for the cost of auditing the delegate Head Start program." OHDS Ex 18. NWCM also requested "responsible and definitive actions" from OHDS, apparently concerning the interpretation of 45 C.F.R. 1301.12, and particularly whether the audit must be for the "grantee Head Start program only" Id.

In a letter of October 20, 1988, the Regional Administrator advised NWCM that it was required to submit an audit to OHDS regardless of any arrangements it had made concerning its delegate contract with the City. OHDS Ex 22. In a letter of November 14, 1988, NWCM noted in a post-script that "NWCM is making every effort to comply with the required audit of the budget period ending December 31, 1987, as soon as possible." OHDS Ex 26.

As of the March 21-23, 1989 hearing, NWCM still had not submitted the required audit for 1987. TR I/86. The claimed justification expressed in testimony was that OHDS was demanding an audit solely of the OHDS funded Head Start program only, which comprised only 20 percent of NWCM's total operations, and that such an audit would not allow OHDS to properly assess NWCM's financial viability. TR I/86-87. However, contrary to NWCM's assertion, the record provides no indication that OHDS would refuse to accept an audit for all of NWCM's operations. E.g., OHDS Ex 22.

NWCM started to hire an auditor to conduct an audit for the 1987 program year, but the auditor was "somewhat skeptical about getting involved and not having a clear understanding of what HHS wants . . ." (apparently referring to the issue of whether the audit should be for the OHDS Head Start grant only.) TR I/87; TR I/158-163. NWCM also submitted two letters from the firm of Blackman, Kallick, and Bartelstein, Certified Public Accountants, to explain the circumstances of its failure to submit the audit. P Ex 2, 3. In a letter of March 22, 1989, apparently prepared for purpose of the hearing, the firm wrote that the 1987 audit "is now scheduled for completion by the end of March 1989." P Ex 2. The record does not indicate whether such an audit was actually submitted. The letter explained that the audit

had been postponed for three reasons: "changes in the entity to be audited" (apparently referring to the loss of the delegate contract with the City); "approval to perform an audit" of the OHDS funded program only; and delay in receiving payment.

Assuming that I would have the authority to consider these excuses for NWCM's failure under the regulations to submit an audit almost one year after it was due, I would not find them to justify the delinquency. The record does not indicate that NWCM sought approval from OHDS to delay submission of the audit for these reasons, and NWCM did not sufficiently explain why they would justify the failure. The regulations unequivocally require such an audit, and NWCM was repeatedly warned of the consequences of its failure to comply with the requirement. Especially given the precarious financial condition of the entity, OHDS in this case had a compelling need to evaluate the current financial status of the organization.

I find that OHDS had a reasonable basis for denying refunding for the 1989 program year, when the grantee had not yet submitted a required independent audit for the program year 1987.

IV. Failure to meet non-Federal matching requirements and failure to maintain accurate and current accounting records.

The federal funds to a Head Start program must be matched by a 25 percent non-federal share, or the total cost of the program has to be matched by 20 percent of a non-federal share. TR III/22, 45 C.F.R. 1301.20. Further, the corporation (NWCM) is responsible under 45 C.F.R. 1320 for proper recording of the matching funds or in-kind contributions, and for showing by verifiable records that the matching requirements have been met. The Regional Administrator found a "serious shortfall" in NWCM's non-federal match. As of September 30, 1988, OHDS found a non-federal match of only \$21,121.38 out of a required match of \$73,368.

NWCM's fiscal officer acknowledged in testimony the existence of this shortfall at the time of OHDS's determination, but nonetheless maintained that NWCM had since then met its non-federal match through "in-kind contributions." The fiscal officer testified that NWCM "got a heavy amount of in-kind contribution" in the last part of 1988, which fulfilled its required non-federal share. TR I/88. The written record does not substantiate this testimony, however. The amount of

in-kind contributions (presumably from volunteer activities) would need to be substantial, and the witness did not offer any details of the circumstances underlying his assertion. OHDS itself would be unable without written documentation to accept NWCM's claim of compliance.

Another regulatory requirement is that a grantee make and keep accurate, current, and complete disclosure of the financial results of each project or program. 45 C.F.R. 74.61(a). OHDS found that the failure to meet the non-federal share may have been due to the lack of accurate records concerning contributions, which itself was a violation of this requirement.

V. Failure to keep OHDS informed as required.

The Regulations require specifically that grantees must submit quarterly performance reports within 30 days after the close of each quarter. 45 C.F.R. 74.82(b). However, as OHDS Ex 27 demonstrates, NWCM submitted its reports for both the quarters of "March, 1988 through May, 1988" and "June, 1988 through August, 1988" on November 21, 1988, well beyond their due dates. See TR III/24.

OHDS also objected to NWCM's failure to notify OHDS of the fact that the Internal Revenue Service had filed a lien against the City of Chicago on May 23, 1988 because of unpaid FICA taxes due from NWCM for the period ending December 31, 1987. 45 C.F.R. 74.84 requires a grantee to notify the granting agency of events which "have significant impact upon the grant . . . activity." Given OHDS's clearly stated concern about NWCM's financial situation, I agree that failure to notify OHDS about the status of its debt to the IRS was further ground for not renewing the grant.

VI. Failure to submit an approvable application for refunding.

OHDS gave NWCM a full opportunity to submit an approvable application for refunding for 1989. OHDS's ultimate objection to NWCM's application for refunding set forth a number of concerns too numerous to mention. One major objection to the application was that it failed to contain approval from the Parent Policy Council, as required by 45 C.F.R. Part 1304, Appendix B. That section provides for policy groups (comprised of at least 50% of children's parents enrolled in the program) to be actively involved in policy making and in operation of the Head Start program.

OHDS agreed to accept the late filing of NWCM's 1989 grant application on October 12, 1988. In a letter of October 21, 1988, OHDS returned the grant application, stating that the application was "unacceptable for formal review and processing by OHDS," noting a series of problems with the application that it would allow NWCM to further address in another application. OHDS Ex 24. The first problem cited was NWCM's failure to include proper evidence of Parent Policy Council approval. As noted by OHDS's October 21, 1988 letter, the minutes of the meetings of the Parent Policy Council indicated that only two parents were present at one meeting on October 12, 1988, and three parents were present at a meeting on October 6, 1988. OHDS Ex 21. The letter also noted that the minutes of the meetings were not signed. OHDS raised concern about whether three parents constituted a proper quorum under the bylaws of the Council, and, generally, whether there was a sufficient level of parent involvement in the decision-making at the organization.

The application resubmitted on November 4, 1988 failed to contain any evidence of parent approval of the revised application, and merely included a copy of the same Parent Policy Council minutes which OHDS had found to be insufficient in the initial application. OHDS Ex 28.

The NWCM Assistant Program Director testified about the circumstances of the Parent Policy Council approval of the 1989 grant application. TR III/218-228. The NWCM Parent Policy Council had seven members, but the assistant program director could not recall if the bylaws stated whether a majority of four was required for a quorum. TR III/224. The Council had approved the initial application for funding, but after NWCM received the rejected application back from OHDS, "the parents met and worked with us to give the additional information and we didn't feel that we needed a new approval from the Parent Policy Committee, because that was the same budget that we were working with." TR III/226; see also TR I/173. The record does not reflect that the Parent Policy Council met between the OHDS return date (October 21, 1988) and the resubmission of the application on November 4, 1988.

While the record concerning the Parent Policy Council approval is less than clear, I agree with OHDS that NWCM should at least have clarified whether the Parent Policy Council had properly approved the application when it was resubmitted on November 4, 1988.

The other major problem which OHDS noted concerning the resubmitted application by NWCM was that it included

administrative and development costs which exceeded the 15 percent limitation as required by 45 C.F.R. 1301.32. NWCM did not deny that it exceeded the amount of allowable costs here, but its chief fiscal officer claimed that there was confusion as to whether the non-federal part of administrative costs needed to be included in calculating the allowable costs. T I/180-184.

NWCM's explanation is not persuasive, since NWCM easily could have inquired about the meaning of the regulatory limit. 45 C.F.R. 1301.32 clearly states that the costs of administration and development shall not exceed 15 percent of the total costs of the program, meaning all administration and development costs, not just those of the federal share. The obvious purpose of the limitation is to ensure the efficient operation of the grant program, and I find NWCM's failure to meet this requirement was a proper ground on which to reject its application for refunding and for denying refunding of the grant for the 1989 program year.

VII. Failure to notify OHDS in writing regarding maintenance of financial viability.

45 C.F.R. 1302.20 provides:

(a) Upon the occurrence of a change in the legal condition of a grantee or of a substantial diminution of the financial resources of a grantee, or both, . . . the grantee is required within 30 days after the . . . grantee has notice of knowledge of the change, . . . to show in writing to the satisfaction of the responsible HHS official that it has and will continue to have legal status and financial viability. Failure to make this showing may result in suspension, termination or denial of refunding.

OHDS's December 22, 1988 determination letter found that NWCM had violated this provision by not notifying OHDS of a tax lien imposed by the Internal Revenue Service on NWCM on May 23, 1988, in the amount of \$136,368.58, which OHDS found constituted a "substantial diminution of the financial resources" of NWCM. NWCM presented no response at the hearing to this OHDS complaint.

The record also demonstrates that the Regional Administrator of OHDS, in renewing NWCM's grant for 1988 subject to special conditions, warned NWCM of OHDS's continuing concern about the financial viability of the organization. As found above, NWCM did not implement a

viable deficit reduction plan, nor does the record indicate that it adequately continued to keep OHDS informed of its financial status. Although NWCM submitted a deficit reduction plan on February 17, 1988 (see OHDS Ex 8), the organization did not apprise OHDS of how it was complying with the plan over the course of the year, and the record does not indicate that any true progress indeed was made or that its debt was in any way reduced.

I therefore conclude that NWCM's failure to keep OHDS informed of the organization's financial status was further ground to deny refunding.

CONCLUSION

Based on the foregoing, I find and conclude that NWCM did not demonstrate that it met the OHDS compliance standards in a timely manner in order to be restored refunding for its Head Start direct grant for 1989. Further, I find and conclude that OHDS has supported its determination to deny NWCM its 1989 refunding based on the entire record in this case and the applicable federal Regulations.

/s/

Charles E. Stratton
Administrative Law Judge