

Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: North Central West DATE: December 6, 1996
 Virginia Community Action
 Association, Inc.
 Audit Control No. A-03-94-33016
 Docket Nos. A-95-115
 A-95-132
 Decision No. 1604

DECISION

The North Central West Virginia Community Action Association, Inc. (North Central) appealed two determinations by the Administration for Children and Families (ACF) disallowing a total of \$55,094 claimed by North Central for reimbursement of indirect costs for the periods July 1, 1992 through June 30, 1993, program year 27 (PY 27), and July 1, 1993 through June 30, 1994, program year 28 (PY 28).¹ ACF disallowed the amount of indirect costs charged to North Central's Head Start program which exceeded what was allowable under North Central's final indirect cost rate.²

For the reasons stated below, we conclude that the disallowances were proper since North Central was required to claim indirect costs in accordance with its approved final indirect cost rate. Moreover, there is no support in the record for North Central's assertion that the PY 27 disallowance was offset by "corporate" funds used for Head Start purposes. As discussed below,

¹ The disallowance amount for Docket No. A-95-115 is \$24,813, and the disallowance amount for Docket No. A-95-132 is \$30,281. Additionally, while the grant numbers for both program years are noted in the record, only the audit control number for PY 27 is noted in the record. Therefore, it is the only one listed in the caption.

² Both parties agreed that the issues in these two appeals were the same. Thus, both parties agreed that these cases should be consolidated for purposes of briefing and decision.

however, we determine that ACF improperly calculated the disallowance amount for PY 27, based on the incorrect amount of indirect costs charged to the Head Start program. Consequently, we uphold the PY 28 disallowance and remand the PY 27 disallowance to ACF for recalculation in accordance with our determination below.

Background

North Central is a non-profit community action agency which operates various programs, including Head Start, that provide services to low income individuals and families in parts of West Virginia. North Central has been a federal grantee agency for twenty-nine years.

Prior to July 1, 1992, North Central operated on a cash basis accounting system and charged all of its costs directly. However, the West Virginia State Auditor, in the Governor's Office of Community and Industrial Development, determined that Office of Management and Budget (OMB) Circular A-122 (A-122)³, which was effective as of June 27, 1980, required each non-profit agency to have an approved indirect cost rate in place.⁴ Consequently, on March 3, 1992, the State Auditor sent a memorandum to "Executive Directors" directing each non-profit agency that did not have an approved indirect cost rate to immediately initiate the process of preparing an indirect cost proposal and to submit the proposal to the cognizant federal agency for approval. See North Central's exhibit (Ex.) 1. North Central was required to submit its proposal to the Division of Cost Allocation (DCA), in the Department of Health and Human Services, for approval.

³ OMB A-122 is made applicable to the grants in question here by 45 C.F.R. § 74.174(a).

⁴ Indirect costs are those costs necessary for the overall operation of an organization but which are not readily identifiable with a particular project. Costs such as administrative salaries and fringe benefits are typically charged indirectly. Indirect costs are charged to a particular grant or contract by means of an indirect cost rate. An indirect cost rate is a percentage representing the ratio of an organization's allowable indirect costs to its allowable direct costs. See OMB A-122, Attachment A, C.1. and 2.

North Central stated that on June 17, 1992 it submitted to DCA its initial proposal for a provisional indirect cost rate for PY 27 of 9.7%.⁵ ACF stated that on January 13, 1993, North Central submitted a revised proposal, dated October 13, 1992, for a provisional indirect cost rate for PY 27 of 11.2%. ACF's Ex. 5 at 1. Beginning with PY 27, North Central changed its accounting system to an accrual method and instituted an indirect cost recovery system.

On March 26, 1993, DCA issued a rate agreement that notified North Central that it had an approved provisional indirect cost rate of 9.6% for PY 27 and that a provisional indirect cost rate of 9.6% would also be effective from July 1, 1993 until amended. See North Central's Ex. 4 at 1. On January 3, 1995, DCA issued another rate agreement that notified North Central that it had an approved final indirect cost rate of 9.6% for PY 27 and PY 28 and that a provisional indirect cost rate of 12.1% would be effective from July 1, 1994 until amended. See ACF's Ex. 8 at 1. A North Central official signed both agreements, without indicating any dispute with the final rates.

By disallowance letters dated April 7⁶ and May 3, 1995, ACF notified North Central that it was disallowing \$24,813 and \$30,281 in federal financial participation claimed as indirect costs under the Head Start program for PY 27 and PY 28, respectively. ACF determined that North Central charged indirect costs to the Head Start

⁵ ACF disputed that North Central submitted the June 1992 proposal. ACF said, in relevant part, "[n]either ACF nor DCA has any record of having received this proposal at that time. . . . Nevertheless, DCA negotiated with [North Central] based on its revised proposal, and neither DCA nor ACF penalized [North Central] for the untimeliness of its proposal." ACF's brief (Br.) at 4, note 4.

⁶ It appears that ACF sent North Central two letters on April 7, 1995. Both letters were from the Regional Administrator and addressed to North Central's Executive Director. One letter (the disallowance letter) notified North Central of the disallowance for PY 27 and its appeal rights to this Board. The other letter (the resolution of findings letter) provided a final determination and resolution of findings resulting from the on-site/technical assistance visit performed on October 26-28, 1994. See North Central's Ex. 13.

program without regard to the approved indirect cost rate. North Central appealed the disallowances.

Analysis

We first address North Central's arguments applicable to both program years that (1) there were mitigating circumstances which led to its excess claim; (2) it was not advised by DCA of its right to appeal a rate determination with which it disagreed; (3) it did not file proposals for higher final rates based on DCA's representation that an audit was required before it could do so; and (4) the approved rates were actually higher than 9.6% for PY 27 and PY 28. Thereafter, we discuss North Central's argument that "corporate" funds used for Head Start offset the PY 27 disallowance and that ACF improperly calculated the disallowance for PY 27.

At the outset, North Central admitted that its initial indirect cost recovery process resulted in a claim for more indirect costs than it was entitled to under its approved provisional rate for PY 27 and PY 28. (The provisional and final rates for these program years were the same.) However, North Central argued that there were mitigating circumstances. North Central asserted that its incorrect claiming was attributable to its software system. During PY 27, North Central had changed software systems. The new system, rather than determining indirect costs on an approved provisional rate basis, determined them on an actual basis. North Central explained that it was not until fiscal year 1995 (PY 29) that it became aware of its incorrect procedure for collecting and reporting indirect costs. See North Central's notices of appeal, dated April 19, and May 26, 1995. North Central also explained that during PY 27, it combined bank accounts for all programs into one operating cash account, and that it was still in a "learning curve" period in its conversion from a cash to an accrual method of accounting. North Central's April 19, 1995 notice of appeal at 1-2.

ACF did not dispute North Central's assertions. However, the issue before us is whether North Central established that the disallowed costs were claimed in accordance with its approved indirect cost rate. We have no authority to reduce or waive the disallowances based on mitigating circumstances, including those identified by North Central here. ACF awarded grants to North Central for PY 27 on July 7, 1992 and for PY 28 on July 16, 1993. See ACF's Exs. 6 and 7. The awards incorporated by reference a statement of terms and conditions which governed the subject grant. The terms and conditions of the award

required compliance with the cost principles in OMB A-122 and limited indirect cost reimbursement to the rate established in accordance with those principles. ACF's Ex. 6 at 4 and 9.

The Board has long held that we decide only the merits of the dispute between parties, and that the Board has no authority to waive a disallowance. See, e.g., Guam Dept. of Public Health and Social Services, DAB No. 1050 (1989). Since the disallowances were clearly warranted under the applicable regulations and policies, we have no authority here to overturn them based on North Central's mitigating circumstances.

Next, North Central acknowledged that it signed the rate agreement which DCA executed and forwarded to it on March 26, 1993 establishing a provisional 9.6% indirect cost rate for North Central's Head Start program. However, North Central argued that it signed the rate agreement only because it believed that it was required to do so, and that at no time did DCA advise North Central that it had a right to seek a resolution of any disputes arising from the rate agreement negotiation.⁷ North Central cited OMB A-122 and two provisions of 45 C.F.R. Part 75 as support for its argument.

OMB A-122, E.2.h. provides:

If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the non-profit organization, the dispute shall be resolved

⁷ North Central also asserted that DCA advised it that North Central's revised indirect cost proposal to increase its indirect cost rate to 11.2% would not be approved because it was untimely. ACF denied this allegation, see note 5 above, and asserted that a rate agreement was reached on March 26, 1993 after consideration by DCA of the revised indirect cost proposal. North Central did not present any evidence to support its allegation. Further, North Central stated that, for PY 29, DCA included other costs in the indirect cost pool and approved North Central's actual fringe benefit rate. North Central argued that this shows that its 1992 revised indirect cost proposal was reasonable and is now being embraced by DCA. However, since North Central signed the rate agreement for the 9.6% provisional indirect cost rate, these actions do not provide a basis for reversing the disallowances, even if true. Therefore, we do not discuss any of these allegations further.

in accordance with the appeals procedures of the cognizant agency.

Further, 45 C.F.R. § 75.4 provides:

Where an agreement cannot be reached between the Director, DCA, and the grantee, the Director, DCA will promptly notify the grantee in writing of the Director's determination. This notification will set forth the reasons for the determination in sufficient detail to enable the grantee to respond and will inform the grantee of its opportunity for reconsideration under this subpart.

Finally, 45 C.F.R. § 75.6(c) provides, in relevant part:

If the Regional Director's decision is adverse to the grantee's position, this notification will state the basis of the decision and will inform the grantee of its right to appeal the decision to the Departmental . . . Appeals Board under Part 16 of this title.

North Central maintained that if it had known about the dispute process, it would have used the process since it believed it had other allowable costs that were not considered in the formulation of the indirect cost rate.⁸

We conclude that North Central's argument has no merit. While North Central did not start to claim indirect costs until PY 27, North Central has over two decades of experience as a recipient of federal funds. Thus, it is reasonable to expect North Central to know that it could not be "required" to sign an agreement which it disputed. Moreover, OMB A-122 provided explicit notice that there

⁸ Among other things, North Central argued that it could use historical data to show that approximately \$20,000 in costs such as postage and telephone charges, which could have been charged directly, had been added to "our pool for indirect cost recovery." See North Central's April 19, 1995 notice of appeal at 3. North Central asserted that accordingly the disallowance could be offset by those costs and its indirect cost recovery reduced. North Central admitted that its calculations were only a projection. We do not consider this argument further since North Central did not rely on its audit reports or any financial data for the proposition that certain costs had been misclassified in the indirect cost recovery process and should therefore be paid as direct program costs.

is an appeals procedure for rate disputes and that appeals procedure is set forth in published regulations at 45 C.F.R. Part 75.

We find that North Central should have been aware of the OMB A-122 provision for two reasons. First, the State Auditor, in his March 3, 1992 memorandum, referenced OMB A-122 and required each agency to comply with the indirect cost rate provisions. Hence, it is reasonable to expect that North Central would familiarize itself with all of the applicable provisions of OMB A-122, especially in light of the fact that this was North Central's first experience with this process. Second, in its indirect cost proposals, North Central stated that it had classified costs as direct or indirect "in accordance with the principles contained in OMB Circular A-122." See North Central Exs. 2 and 3 at 2. Thus, North Central should have been aware of its right to appeal a rate determination whether or not DCA also advised it of this right.

Further, North Central has not presented any evidence to show that it notified DCA that it did not agree with, or did not want to sign, the March 26, 1993 rate agreement sent to it by DCA. Consequently, DCA was not required to comply with the provisions of 45 C.F.R. § 75.4, which explains the notice that DCA must give when an agreement on the rate is not reached. When a negotiated agreement is not reached, DCA issues a unilateral determination that includes information about appeal rights. See ACF's Ex. 5. Similarly, section 75.6(c) requires notice of the right to appeal an adverse determination by the Regional Director on an indirect cost rate appeal. Such notice was not required here because North Central did not appeal the indirect cost rate. Therefore, we find that North Central's arguments that DCA failed to notify it of its right to appeal the rate determination do not provide a basis on which to overturn ACF's disallowances.

In addition, North Central argued that following the establishment of the provisional indirect cost rate for PY 27, DCA told North Central that it could not seek a final rate for PY 27 or a provisional rate for PY 28 without the submission of an audit with its proposals, and that North Central reasonably relied on DCA's representation and did not submit further proposals because it did not have an audit at that time.⁹ North

⁹ We note that, according to the March 26, 1993 rate agreement, North Central did have a provisional rate
(continued...)

Central's argument is, in effect, that ACF should be estopped from taking these disallowances since, but for DCA's representation, North Central might have submitted timely proposals and negotiated higher final rates. However, North Central did not establish the existence of the basic elements of estoppel under the circumstances of this case. As the Board has stated, there can be no estoppel absent the traditional elements of a misrepresentation of fact, reasonable reliance, and detriment to the opposing party.¹⁰ Nisqually Indian Tribe, DAB No. 1210 at 7 (1990). Since there was no action taken detrimental to North Central, however, North Central could not establish the traditional grounds for estoppel. DCA negotiated with North Central and issued a final rate agreement despite North Central's late proposals. North Central signed the January 1995 final rate agreement without indicating that it disagreed. Moreover, regardless of any statements allegedly made by DCA personnel, as stated above, North Central could not reasonably have relied on any oral advice concerning submission of an audit report to support an indirect cost rate proposal as changing the due date for submission of the proposal that was explicitly stated in the written terms of the grant award.¹¹ North Central had notice of and was required to comply with all the terms and conditions of the grant, including the time requirements

⁹(...continued)

of 9.6% for PY 28 until amended. See North Central's Ex. 4.

¹⁰ We do not intend by this decision to imply that estoppel necessarily would lie against the federal government if the four elements of estoppel had been established. See, e.g., Office of Personnel Management v. Richmond, 496 U.S. 414 (1990). But, having concluded that North Central has not satisfied all of the traditional elements, we do not discuss further considerations involved in determining whether a federal agency may be estopped.

¹¹ ACF asserted that DCA did not make such representations, and North Central did not provide any evidence to show that DCA made such alleged statements. In any event, we find that whether DCA did or did not make such representations is not determinative of the issues in these appeals.

for the filing of any indirect cost proposals. OMB A-122, Attachment A, E.2., provides, in relevant part:

b. A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall submit its indirect cost proposal after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

North Central was obligated to abide by all applicable written federal requirements. We cannot reduce a disallowance of claims made in excess of a final indirect cost rate because in retrospect a grantee wishes it had taken a different or more timely approach when negotiating its rates.

Further, North Central argued that when calculated using management and administration (M&A) positions and M&A percentages as approved in an addendum to the January 3, 1995 rate agreement, North Central's indirect cost rate for PY 27 is 10.8% and 12.3% for PY 28, not 9.6%. North Central's Brief at 14. North Central did not explain how it calculated these higher rates. Moreover, the record shows that the 9.6% final rate for PYs 27 and 28 and the 12.1% provisional rate for PY 29 were negotiated based on different indirect cost rate proposals containing different cost information. ACF's Ex. 5 at 3. The M&A positions and percentages in the addendum are the same as those proposed for PY 29 (with the addition of a bookkeeper position charged at 100%). North Central's Exs. 6, 7, and 9. Therefore, we determine that there is no merit to the assertion that the final rates for PYs 27 and 28 should be recalculated upward. The signed final indirect cost rate agreement definitively determines the allowable indirect cost recovery; therefore, despite North Central's arguments to the contrary, we find that the final indirect cost rate was 9.6% for PY 27 and PY 28.

North Central also asserted that it "overspent its Head Start budget" and accounted for the "deficit through [its] 'corporate' account." North Central's April 19, 1995 notice of appeal at 3. ACF disagreed that North Central had documented allowable, allocable program costs paid from its funds which could be used to account for the amount of the PY 27 disallowance. ACF's letter of

September 10, 1996 at 5. From a review of the audit reports, we find that there is no basis in the record to support North Central's contention. The PY 27 audit shows a shortfall of \$36,518 for the Head Start program and the PY 28 audit shows a transfer of non-federal funds of \$36,517 to correct the prior year fund deficit. In addition, the PY 27 audit shows accounts payable of over \$250,000, deferred revenue of \$369,341, and grants receivable of over \$300,000, without specifying the programs to which these balances apply. North Central's Ex. 5 at 3 and 20 and Ex. 11 at 22. North Central did not explain why in light of its receivable and payables balances the audit report would substantiate its claim and did not provide any other records or data. We cannot find just from the audit schedules that North Central accounted for all federal funds it received by allowable, allocable costs incurred and paid for Head Start purposes so that the unallowable indirect cost charges can be attributed to "corporate" funds. Therefore there is no reason based on this allegation to reduce the disallowance for PY 27.

Finally, North Central argued that, while the disallowance for PY 27 of \$24,813 for reimbursement of indirect costs was calculated based on total indirect costs of \$175,271, the audit report for PY 27 shows that North Central claimed only \$167,769 in indirect costs for the Head Start program.¹² See North Central's Ex. 5 at 61. In addition to the audit report, North Central submitted the resolution of findings letter, dated April 7, 1995, from Ralph E. Douglas, Regional Administrator, to North Central's Executive Director, Kenneth Dean. In that letter, at page 1, Mr. Douglas stated, among other things, that --

all indirect costs in the amount of [\$167,769],¹³

¹² In the disallowance letter, ACF stated that the total base costs for PY 27 were \$1,567,277, and that the approved rate of 9.6% applied to the base costs equalled \$150,458. ACF subtracted \$150,458 from \$175,271, which ACF said was the total indirect costs claimed by North Central for its Head Start program, and disallowed the difference between the two amounts. Before the Board, ACF simply asserted that \$175,271 was the correct figure to use.

¹³ The Regional Administrator's letter referenced the audit report, but stated the amount to be \$167,679. We assume that 679 was transposed and should have been (continued...)

which were charged to the Head Start program have been questioned in your organization's single agency audit for this period.

North Central's Ex. 13 at 4. Thus, North Central concluded that, assuming the disallowance for PY 27 is proper, the disallowance amount should be reduced to \$17,311.

While ACF maintained that the audited financial statement indicates that North Central spent \$175,271 for indirect costs for its Head Start program, and therefore ACF used the correct figure in calculating the disallowance, ACF is wrong. After review of the audit reports for both program years, we find that the confusion regarding the proper figure to use to calculate the disallowance amount can be traced back to the PY 27 audit report. The Head Start grant, No. 03CH2484/27, that we are concerned with in this case was apparently combined with a Head Start Family Services grant in the PY 27 audit report. See North Central's Ex. 5 at 4 and 14. Thus, while the total amount of indirect costs for both the Head Start program and the Head Start Family Services grant was \$175,271 in PY 27, the audit report questioned only \$167,769 -- the indirect costs that were attributable to Grant No. 03CH2484/27. Id. at 61. Thereafter, in the PY 28 audit report, the auditors listed the expenditures for the Head Start grant at issue here, No. 03CH2484/28, separately from the Head Start Family Services grant.¹⁴ See North Central's Ex. 11 at 4 and 16. Since the auditors combined the Head Start program indirect costs with the Head Start Family Services indirect costs in PY 27 and reported them separately in PY 28, ACF's confusion is understandable. Therefore, we remand the disallowance for PY 27 to ACF for the proper calculation using the correct indirect cost amount of \$167,769. If North Central disagrees with the amount calculated by ACF, North Central may return to the Board on this limited issue only.

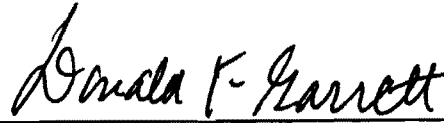
¹³ (...continued)

769, as in the audit report. See North Central's Ex. 5 at 61.

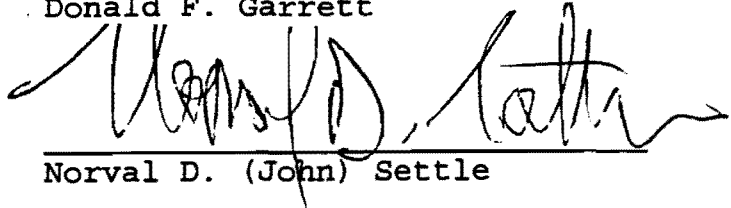
¹⁴ ACF determined that the total base costs for PY 28 were \$1,767,132, and that the approved rate of 9.6% applied to the total direct cost base equalled \$169,644. Using the same method as in the previous program year, ACF subtracted \$169,644 from \$199,925, the amount claimed as Head Start indirect costs in PY 28, and disallowed the difference.

Conclusion

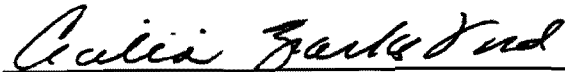
For the reasons stated above, we conclude that North Central was required to claim its indirect costs in accordance with its negotiated final indirect cost rate as evidenced by the signed agreement between North Central and DCA. Therefore, we uphold the disallowance for PY 28. However, as previously discussed, we determine that ACF improperly calculated the disallowance amount for PY 27. Accordingly, we remand the PY 27 disallowance to ACF for the proper calculation. If North Central disagrees with the amount calculated by ACF, North Central may return to the Board on this limited issue only.



Donald F. Garrett



Norval D. (John) Settle



Cecilia Sparks Ford
Presiding Board Member