

Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Beaver County Head Start
Docket No. A-11-114
Decision No. 2441
February 14, 2012

DECISION

Beaver County Head Start (BCHS) appeals the determination of the Office of Head Start of the Administration for Children and Families (ACF) disallowing \$20,425 in Head Start funds awarded for the year and budget period ending October 31, 2010. ACF disallowed \$19,000 claimed for a building management contract awarded without open competition required by regulation, and \$1,425 in interest on unpaid credit card balances. For the reasons explained, we uphold the disallowance in full.¹

Analysis

- I. We sustain the disallowance of \$19,000 claimed for a building management contract awarded without open competition.

ACF disallowed BCHS's expenditure of \$19,000 in Head Start funds for a building management contract for a Head Start facility BCHS had recently acquired in Ambridge, Pennsylvania. ACF determined that BCHS "did not properly obtain at least two oral quotations" for the contract, in violation of a regulation requiring open competition in procurement transactions. Disallowance notice at 1-2, citing 45 C.F.R. § 74.43. That regulation is part of the administrative requirements for grant awards to nonprofit organizations at 45 C.F.R. Part 74 made applicable to the Head Start program by 45 C.F.R. § 1301.10(a) and states in full:

¹ ACF initially disallowed a total of \$306,078, comprising the above amounts plus \$160,378 BCHS obligated to pay for expenses incurred outside the approved budget period, and \$125,275 awarded to renovate a Head Start facility but used without prior agency approval to renovate a different facility. During the appeal, ACF granted retroactive approval for the expenditure of \$125,275 on a different facility and withdrew the disallowance of \$160,378 spent outside the approved budget period. ACF Br. at 1.

§ 74.43 Competition.

All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft grant applications, or contract specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurements. Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered. Solicitations shall clearly set forth all requirements that the bidder or offeror shall fulfill in order for the bid or offer to be evaluated by the recipient. Any and all bids or offers may be rejected when it is in the recipient's interest to do so.

BCHS does not deny it failed to conduct any competitive selection process. BCHS asserts, however, that the contractor, a real estate development company, "had advanced sums toward the acquisition of a prospective alternative classroom site in Ambridge," that "it would not have been possible to competitively bid the contract due to the existing financial obligation owed to the developer," and that "such bidding was not practical as called for in 45 C.F.R. 74.43." BCHS Br. at 9-10. The real estate management agreement between BCHS and the real estate development company states that one of the reasons that the parties entered into the agreement was because BCHS was indebted to the company.² ACF Ex. 1, at 2.

We conclude that BCHS failed to comply with section 74.43 in awarding the contract because, as it concedes, it permitted no competition for the contract and did not consider awarding the contract to any other company or individual. The requirement to consider more than one potential contractor in awarding a procurement contract is clear from requirements that procurement transactions be conducted through "open and free competition" with "bids and/or requests for proposals" and that awards be made "to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered." 45 C.F.R. § 74.43. Considering only one contractor from the beginning is inconsistent with these requirements. As one federal court addressing the regulation as applied to a state grantee

² BCHS refers to the building management agreement as both a management contract and a maintenance contract or agreement. BCHS Br. at 2, 3, 4, 9, 10. The document in the record is titled "Real Estate Management Agreement." ACF Ex. 1, at 1.

explained, “[t]he regulations at issue impose at least three obligations . . . (1) Open and free competition for all procurement transactions; (2) Awards only to bidders whose bids are responsive to the state’s solicitation; (3) Solicitations for bids including all requirements that the bidder shall fulfill.” *Value Behavioral Health, Inc. v. Ohio Dept. of Mental Health, et al.*, 966 F.Supp. 557, at 569 (S.D. Ohio 1997). Section 74.43, the court found, “includes affirmative, binding language, which tells the [grantees] that they ‘shall’ follow each of the three standards set forth above.” *Id.* at 571. “The benchmark requirement” of the regulation, the court stated, “is that the process be ‘open and fair.’” *Id.* at 570. While the grantee “is free to select from a wide range of bidding methods, it may not select a process that does not give a fair and open chance to qualified bidders or a process that provides advantages or information to one bidder without according the same to all bidders.” *Id.* Because BCHS admittedly made no effort to consider or solicit other potential contractors, it failed to comply with the requirements of section 74.43 when it awarded the contract to manage the Ambridge Head Start facility.

BCHS’s argument that its debt to the real estate development company precluded soliciting bids or otherwise considering other contractors is unavailing. BCHS has also not explained why its outstanding debt to the real estate development company prevented it from soliciting offers to manage the Ambridge facility. Nothing in the regulations suggests that a pre-existing, unrelated debt to one bidder justifies awarding a contract to that bidder as a sole source. Furthermore, the argument raises additional questions about the allowability of the \$19,000 charged to Head Start funds during the fiscal year for the contract. BCHS states that “[o]ver the course of twelve (12) months BCHS paid a total of \$26,940.00 in management fees,” of which “a total of \$12,500.00 went to reimburse” the real estate development company for monies it had previously advanced to BCHS, and “a total of \$5,205.00 in actual operating expenses were incurred” by the real estate development company, meaning that “the development company earned a total of \$9,235.00 for managing the reconstruction of the building and overseeing the operation for a total period of eighteen (18) months.” BCHS Br. at 10. BCHS concedes that the case thus “does not factually involve the expenditure of \$19,000” and that “the primary purpose of the agreement was to reimburse an unrelated company for specific costs that it had advanced and agreed to continue to pay on behalf of BCHS.” BCHS Reply at 2-3. This indicates that the \$19,000 BCHS charged to Head Start funds for its payments under the management agreement substantially exceeded the value of the services BCHS received and therefore may well have been unallowable under applicable cost principles. See 2 C.F.R. Part 230, App. A, ¶¶ A.2 (allowable cost must “[b]e reasonable for the performance of the award and be allocable thereto”); A.3 (cost is reasonable if “it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs”); A.4 (cost is allocable to

an award “in accordance with the relative benefits received”).³ BCHS has not shown that its loan repayment was an allowable charge under the cost principles, nor denied that it charged the loan repayment amount to federal Head Start grant funds. In any case, we find nothing in BCHS’s explanation of its debt to the contractor that exempts BCHS from the requirement to select a building management company by competitive means.

As further evidence of BCHS’s failure to comply with the regulation requiring open competition in procurement transactions, ACF states that the real estate development company “is owned by Beaver County’s counsel and board member,” to whom we refer here by the initials A.T. ACF Br. at 3, citing ACF Ex. 1. ACF cites the real estate management agreement for the Ambridge facility, which A.T. signed as manager of the real estate development company, but does not identify any evidence in the record proving that he was a BCHS board member.⁴ ACF Ex. 1. With its reply brief, BCHS submitted an affidavit from the chairman of the board of Civic Senior Citizens Club, Inc. (CSCC), which administered the Beaver County Head Start program, stating that A.T. is both CSCC/BCHS counsel and the owner of the real estate development company but has never served as a board member, director, officer or employee of CSCC.⁵ BCHS Reply, Aff. at ¶¶ 9, 10. This is consistent with CSCC “Grantee Board Meeting Minutes” showing that A.T. attended meetings as the grantee’s attorney. BCHS Br., undesignated exhibit. As attorney for BCHS, A.T. was its agent regardless of whether he served under contract, as an employee, or pro bono, even if he was not a member of the board. In contracting with a company managed by its own attorney, without the open competition required by the section 74.43, BCHS failed to comply with the additional requirement of that regulation that a grant recipient “shall be alert to organizational conflicts of interest as well as noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade.”

³ Part 230 of 2 C.F.R. contains Office of Management and Budget Circular A-122, “Cost Principles for Nonprofit Organizations.” Its provisions are made applicable to Head Start grants by 45 C.F.R. §§ 1301.10(a) and 74.27(a).

⁴ The disallowance notice states that BCHS’s failure to obtain least two oral quotations for the building management contract also violated 45 C.F.R. § 74.42, “Codes of conduct,” which forbids any “employee, officer, or agent” of a grantee from participating “in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved,” and explains that “[s]uch a conflict would arise when the employee, officer, or agent . . . has a financial or other interest in the firm selected for an award.” Disallowance notice at 1. The disallowance notice does not explain how BCHS’s failure to compete the building management contract violated section 74.42, and before the Board ACF did not address section 74.42 as a ground for the disallowance. As the record does not demonstrate whether A.T. participated in the selection of the contractor, and as BCHS’s failure to comply with section 74.43 justifies the disallowance, we do not address section 74.42 further. We note, however, that A.T.’s status as an agent of BCHS does at least raise questions about whether the decision to award the contract to a company he owned was made in the arm’s length manner required by section 74.42 and whether there existed a real or apparent conflict of interest forbidden by that regulation.

⁵ CSCC has since relinquished the Head Start grant. BCHS Br. at 2.

BCHS also appears to argue that the requirements of 45 C.F.R. § 74.43 do not apply because “[t]he net amount thus actually paid to the contractor is well below the small purchase threshold fixed by 41 U.S.C. 403(11) and OMB Circular [A]-110 Section 44.” BCCHS Reply at 2; *see also id.* at 3 (the “nominal amount at issue that was paid for assisting BCCHS in the redevelopment and operation of its newly-acquired commercial property does not violate the procurement standards applicable to non-profit grantees such as BCCHS as contained in 45 CFR 74.40-48.”). The Department of Health and Human Services has codified the requirements of Circular A-110 at 45 C.F.R. Part 74. *See* 59 Fed. Reg. 43,754 (Aug. 25, 1994) (interim final rule publishing Part 74). The requirements of “section 44” of Circular A-122, “Procurement procedures,” appear at 45 C.F.R. § 75.44. As relevant to BCCHS’s argument, it requires grant recipients to make available “procurement documents such as requests for proposals or invitations for bids, independent cost estimates, etc.,” when, among other conditions, “[t]he procurement is expected to exceed the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently \$100,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.”⁶ 45 C.F.R. § 74.44(e)(2). That threshold restriction, however, does not appear in section 74.43, which applies simply to “[a]ll procurement transactions.” The record production requirements of section 74.44 are not at issue here.

II. We sustain the disallowance of \$1,425 in interest on credit card debt.

ACF determined that “[i]nterest expense totaling \$1,425 on unpaid credit card balances was paid with Head Start funds during the budget period indicated which is not permitted to be charged to the Head Start program.” Disallowance notice at 1. ACF cited cost principles stating in relevant part that “[c]osts incurred for interest on borrowed capital, temporary use of endowment funds, or the use of the non-profit organization’s own funds, however represented, are unallowable.” 45 C.F.R. Part 230, App. B, ¶ 23. BCCHS did not address the disallowance of interest charges in any of its submissions in this appeal.

In failing to allege any error in ACF’s disallowance determination, Beaver County has not met its basic burden as a grantee of documenting the allowability of its expenditures of federal funds. *See, e.g., Arlington Community Action Program, Inc.*, DAB No. 2141, at 2 (2008) (citations omitted) (in appeals of disallowances, grantee “bears the burden of demonstrating the allowability and allocability of costs for which it received federal funding”); *Missouri Dept. of Social Services*, DAB No. 448 (1983) (federal agency must provide sufficient detail concerning the basis for the disallowance to enable the grantee

⁶ The definition of “simplified acquisition threshold” was moved to 41 U.S.C. § 134 effective January 4, 2001. Pub. L. No. 111-350, § 3 (2011). Prior to October 13, 1994 the simplified acquisition threshold was called the “small purchase threshold.” Pub. L. No. 103-355, § 4001 (1994); Pub. L. No. 101-510, § 806(a)(1) (1990).

state to respond, but the ultimate burden of documenting the allowability of costs claimed rests with the appellant).

Moreover, we see no reason why the cost principle quoted above is not on its face applicable to the interest expenses on credit card debt that BCHS charged to Head Start funds. *See, e.g., Southeast Mississippi Community Action Agency*, DAB No. 320, at 3-4 (1982) (upholding disallowance of charges for interest on the assessment of state unemployment taxes, on a bank loan obtained to meet payroll obligations, and under a lease-purchase agreement for a copier, based on former provision of Part 74 stating that “[c]osts incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable”). Accordingly, we sustain the disallowance of \$1,425 in interest on unpaid credit card balances.

Conclusion

For the reasons discussed above, we sustain the disallowance of \$20,425 in Head Start funds awarded for the year ending October 31, 2010.

/s/

Stephen M. Godek

/s/

Constance B. Tobias

/s/

Leslie A. Sussan
Presiding Board Member