

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

Pennsylvania Department of Public Welfare  
Docket No. A-09-88  
Decision No. 2332  
September 23, 2010

**DECISION**

The Pennsylvania Department of Public Welfare (Pennsylvania) appealed a determination of the Administration for Children and Families (ACF) disallowing \$3,135,166 Pennsylvania claimed for federal fiscal year (FFY) 04 as Child Care and Development Fund (CCDF) expenditures. Pennsylvania had reported that it expended funds to improve the quality of infant and toddler care and that, therefore, Pennsylvania was entitled to the \$3,135,166 restricted to use for that purpose. A state audit, however, traced the funds on state accounting records to several contracts for which no funds were budgeted for that purpose. On appeal, Pennsylvania seeks to show that it had other, substitute expenditures to improve the quality of infant and toddler care and also raises a number of issues regarding ACF's authority to disallow the claim.

For the reasons explained below, we conclude that Pennsylvania's arguments have no merit. In particular, we conclude that Pennsylvania has not submitted adequate documentation to show it had expenditures to improve the quality of infant and toddler care for which it has not already claimed other federal funds. Accordingly, we uphold the disallowance in full.

**Legal Background**

The Child Care and Development Block Grant (CCDBG) Act of 1990 authorized grants to states for child care. 42 U.S.C. § 9858 *et seq.* The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), as amended, created the Temporary Families with Needy Children Program (TANF), provided for new entitlement child care funds under section 418 of the Social Security Act, and required that these new federal funds be subject to the CCDBG Act. Pub. L. No. 104-193, as amended by Pub. L. No. 105-33. PRWORA also reauthorized the CCDBG Act and required that all of the child care funds be administered as a unified program. ACF refers to the combined funds as the Child Care and Development Fund (CCDF). Within the CCDF, there are "Discretionary Funds" (federal funds available under the program created under the

original CCDBG Act or transferred from TANF) and “Mandatory” or “Matching Funds” (other funds authorized under PRWORA). Both the Mandatory and Discretionary Funds are 100 percent federal funds—no match is required.

To receive the funds, a state must submit a CCDF plan and must designate a “Lead Agency” to administer the funds. 42 U.S.C. § 9858b(b)(1)(a). States receiving CCDF funds must submit periodic reports (including the sources of assistance for each child) and have an independent audit for each year. 42 U.S.C. § 9858i.

Various restrictions apply to CCDF funds. A grantee must obligate Discretionary Funds either in the fiscal year for which they are awarded or the succeeding fiscal year and must liquidate the obligations within a year after that. 42 U.S.C. § 9858h(c). Funds not timely obligated revert to the federal government. Additional CCDF statutory restrictions include the following:

- A state must ensure that not less than 70 percent of the Mandatory and Matching Funds are used to provide child care assistance to families who are receiving assistance under TANF, families who are attempting through work activities to transition off of such assistance program and families that are at risk of becoming dependent on such assistance program. Social Security Act § 418(b)(2).
- A state must expend an amount that at least equals its allowable expenditures for the title IV-A child care programs during 1994 or 1995, whichever is greater (the “maintenance-of-effort” threshold) before it is eligible for Matching Funds. Social Security Act § 418(a)(2)(C).
- A state that receives CCDF funds shall use not less than four percent of the amount of such funds for designated activities, including activities designed to improve the quality of child care and availability of child care. 42 U.S.C. § 9858e.
- Funds may not be used for construction or major improvements (other than minor remodeling). 42 U.S.C. § 9858d(c).

Since 1999, Congress has added to appropriation laws a restriction that “earmarks” part of the Discretionary Fund to ensure it will be used for improving the quality of care for infants and toddlers (I/T earmark). The expenditure of earmarked amounts is not counted toward meeting the four percent quality expenditure requirement. PA Ex. 20, at 2.

CCDF regulations at 45 C.F.R. Part 98 were promulgated in 1998. The regulations allow states to follow state law to account for funds, but provide that the grantee’s “fiscal and accounting procedures must be sufficient to permit preparation of reports and tracing of funds to a level of expenditure adequate to establish that such funds have not been used in violation of program requirements.” The regulations provide generally that

determinations of whether funds have been obligated and liquidated will be based on “State or local law” or, if there is no applicable state or local law, on the provisions in 45 C.F.R. § 92.3, defining the terms “obligation” and “outlays or expenditures.” 45 C.F.R. § 98.60(d)(4).<sup>1</sup>

The CCDF regulations provide that the statutorily required audits must be conducted in accordance with the Single Audit Act Amendments of 1996 and Office of Management and Budget (OMB) Circular A-133. 45 C.F.R. § 98.65(a). The Single Audit Act was promulgated to establish uniform requirements for audits of grantees with at least a specified amount of federal funds and the Circular provides guidance on those requirements. Lead Agencies are “responsible for ensuring that subgrantees are audited in accordance with appropriate audit requirements.” 45 C.F.R. § 98.65(b). Section 98.65 of the regulations provides:

(d) Any amounts determined through an audit not to have been expended in accordance with these statutory or regulatory provisions, or with the [CCDF] Plan, and that are subsequently disallowed . . . shall be repaid to the Federal government, or the Secretary will offset such amounts against any other CCDF funds to which the Lead Agency is or may be entitled.

(e) Lead Agencies shall provide access to appropriate books, documents, papers and records to allow the Secretary to verify that CCDF funds have been expended in accordance with the statutory and regulatory requirements of the program and with the Plan.

A Pennsylvania Management Directive applies Generally Accepted Accounting Principles to provide policy and guidelines for accounting and reporting procedures that ensure funds “are used properly and for authorized purposes” and that include internal control systems “which result in adequate documentation . . . and the creation and retention of proper audit trails.” ACF Ex. 12, at 2. One of the objectives is completeness and reliability, including that “[f]inancial transactions, supported by related documents must be recorded in the accounts in the period during which they are accruable or occur and be readily traceable from the original document to summary records and to financial reports.” *Id.* at 3. Pennsylvania’s Administrative Manual discusses its responsibility as a recipient of federal funds to ensure it has internal controls and that its subrecipients do as well. ACF Ex. 13.

The CCDF regulations do not specifically refer to the I/T earmark. They do, however, state that the CCDF is “available, subject to the availability of appropriations.” 45 C.F.R. § 98.60(a). The appropriation for FFY 04 made I/T earmark funds available only

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<sup>1</sup> The CCDF regulations state that obligations may include subgrants or contracts that require the payment of funds to a third party, except as specified in the regulations. 45 C.F.R. § 98.60(d)(4).

for limited purposes. ACF issued guidance, however, indicating acceptable uses of I/T earmark funds, including increasing rates paid to child care providers.

### **Factual background**

The Lead Agency for the Commonwealth of Pennsylvania CCDF program is the Department of Public Welfare (DPW). DPW contracts with Child Care Information Services (CCIS) entities to, among other things, make payments to child care providers who furnish day care to children eligible for subsidies. In addition, DPW awards grants to Child Care Resource Developers (CCRDs), which in turn award grants to child care providers for purposes such as doing minor remodeling of their facilities to obtain state licenses or improving the quality of the care they furnish.

The Single Audit Act audit of Pennsylvania's federal fiscal year (FFY) 1999 CCDF program was conducted in 2001, although the audit report was not issued until 2002. The state auditors reported that "DPW and PHHS Comptroller officials stated that they were not aware of the infant and toddler earmark requirement," but that, subsequently, "DPW officials requested the PHHS Comptroller Office to make an expenditure adjustment of \$1,381,114 in an attempt to satisfy the earmark requirement," even though the "grant was fully expended and closed out as of September 30, 2000." PA Ex. 1. The state auditors also reported that the contracts included in the adjustment did not appear to have qualifying expenditures. *Id.* Pennsylvania admitted it was unaware of the requirement, but identified amounts for two CCRDs which it said represented quality initiative grants to providers for infant and toddler projects. *Id.*

ACF elected to attempt to resolve the audit finding by reviewing documents retained by the CCRDs. ACF found that, of the \$2.2 million in expenditures Pennsylvania told ACF were related to I/T, only 72% were so related. ACF Ex. 4. In a January 26, 2004 response to the review, Pennsylvania agreed, among other things, to "put additional clarifications in writing to the CCRDs and other contractors . . . to establish adequate systems for monitoring" and to require them "to identify applicable expenditures during the contracting process." PA Ex. 5. Pennsylvania also agreed to "develop and issue necessary and appropriate reporting forms . . . for use in the tracking and monitoring" of I/T earmark funds. *Id.*

The state audit for FFY 00 found that "DPW claimed \$2,104,931 for infant and toddler quality activities . . . consisting of funds paid to four subrecipients," but that "DPW could provide no documentation to support whether any of these subrecipient payments qualified for inclusion in the infant and toddler earmark." PA Ex. 2. The auditors recommended that "DPW should establish procedures to adequately document, track, and ensure that infant and toddler earmarks are met within future CCDF grants." *Id.*

ACF again reviewed documents related to CCRD expenditures Pennsylvania said were for I/T purposes. ACF found that only 68% of these expenditures related to I/T. ACF Exs. 5, 6.

In a memorandum dated September 1, 2004, Pennsylvania's Director of Child Day Care Services responded to a request for a further description of the corrective actions Pennsylvania planned to implement to address the audit findings. PA Ex. 8. This memorandum described steps to include I/T amounts in the CCRDs' budgets and to have the CCRDs report I/T expenditures on their monthly invoices. ACF did not "formally approve" this plan in writing. PA Ex. 25. State audits for FFYs 01- 03 found that Pennsylvania did not timely implement all of the corrective measures it planned and that there were continuing internal control weaknesses and inadequate support for federal earmarks. ACF Exs. 7, 8; PA Ex. 15. In response to the FFY 03 audit, Pennsylvania said that the "documenting system to identify the obligations and expenditures of the earmark was implemented July 1, 2005," but that "efforts to address this issue will not be realized until SFYE 2006." PA Ex. 15, 3<sup>d</sup> page.

With respect to FFY 04, Pennsylvania's I/T earmark was \$3,135,166. ACF Ex. 1. Prior to September 2005, Pennsylvania had not obligated funds for the FFY 04 I/T earmark although the obligation period ended on September 30, 2005. Pennsylvania's Director of the Bureau of Finance and Planning within the Office of Child Development and Early Learning, DPW (DPW Bureau Director) attested to the following. He decided that using the rate increases reflected in subsidies distributed through the CCISs to qualify for the earmark would "simplify documentation of I/T expenditures during a period when DPW was instituting a new computer system to more precisely track CCRD expenditures." PA Ex. 41 ¶ 6; PA Ex. 48 ¶ 2. As indicated above, ACF guidelines allowed states to use rate increases as a way to improve quality of care.<sup>2</sup> At the time, Pennsylvania contracted with 59 CCISs to distribute subsidies for child care to providers. Since it would take over 100 accounting entries to account for two years of rate increases for 59 CCIS contracts, the DPW Bureau Director asked an ACF financial management specialist whether Pennsylvania needed to record all of the expenditures separately or could make one accounting entry. *Id.* This conversation (which we discuss in detail below) occurred the week of August 29, 2005.

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<sup>2</sup> Pennsylvania did not include rate increases as a planned way to spend I/T earmark funds until its CCDF Plan for FFY 2006-2007. DPW Ex. 18. Pennsylvania acknowledges its expenditures must be in accordance with its Plan, but says its failure to identify rate increases to the I/T earmark in the previous Plan does not matter. We do not need to reach the issue here of whether use of I/T earmark funds for rate increases was inconsistent with the applicable Plan. We note, however, that the lack of any mention in that Plan of use of earmarked funds for the rate increases is an additional reason why assurance is needed that Pennsylvania did not use other federal funds for the rate increases.

That same week, the DPW Bureau Director received a spreadsheet, estimating the amount each of the 59 CCISs would receive as a result of the rate increases for state fiscal year (SFY) 05 and SFY 06 that would be allocable to subsidies for infants and toddlers. PA Ex. 20, at 9-11.<sup>3</sup> The total estimated amount was \$3,746,880.

Pennsylvania then reported this amount as allocable to the FFY 04 I/T earmark on its report to ACF for the period ending September 30, 2005 and on subsequent CCDF reports for FFY 04 funds. PA Ex. 20, at 9 (auditor's notes).

The state auditors found that this claim tracked on the state records to three entries for contract expenditures. PA Ex. 19. The audit workpapers show funds from the FFY 04 I/T earmark account divided between two entries obligating funds for two contracts with Erie County Chief Executive Officer (Erie County) and one entry for a contract with Federation Child Care (Federation), and posting of expenditures to those accounts. PA Ex. 20, at 4-7. The state auditors found (and Pennsylvania does not deny) that the budgets for those contracts contained no line item detail and no separate commitment document for the I/T earmark funds.

When the state auditors questioned the expenditures, Pennsylvania gave them its spreadsheet projecting what payments to each CCIS for the rate increases for each year would be for infants and toddlers. The state auditors found this documentation insufficient since it recorded only projected expenditures, not actual expenditures. PA Ex. 19. The state auditors also found that data from the information system Pennsylvania used to account for CCIS expenditures were unreliable because "on-site monitoring of CCIS front-end child data entry is deficient in that monitoring visits by state officials are limited and activities performed by these officials are not well documented." *Id.* The state auditors also found that under the CCIS audit guidelines for SFY 06, auditors of the CCISs were not required to do audit testing of CCIS reports to support earmark expenditures. *Id.*

The state auditors noted that ACF had agreed to review documentation of the I/T earmark claim for FFY 05. ACF's FFY 05 review report noted that the state auditors had questioned Pennsylvania's claim for \$3,221,990 in earmark expenditures for FFY 05 (more than the \$3,078,776 required). As a result of its on-site review at CCRD offices in Philadelphia and Pittsburgh, ACF found that it was able to verify that there were allowable expenditures of \$801,969.48, but that DPW should return undocumented and unallowable I/T earmark funds in the amount of \$2,276,806.52. PA Ex. 23. In addition, ACF reviewers reported they were told that the Philadelphia "CCRD does not send any reports to DPW to separately identify Infant & Toddler earmark expenditures" and that the Pittsburgh CCRD also did not send such reports. *Id.*, Att. at 4, 5.

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<sup>3</sup> Pennsylvania submitted with its reply brief a revised Exhibit 20 with numbered pages. Our cites to Exhibit 20 are to the revised version.

After ACF disallowed the questioned claims for FFYs 04 and 05, Pennsylvania requested reconsideration by ACF. The Acting Assistant Secretary for Children and Families upheld the disallowance based on the on-site review (which he said confirmed the state audit finding), on Pennsylvania's failure to take agreed-upon corrective actions after the prior audits, and on his review of the statute and regulations.

After Pennsylvania appealed this determination to the Board, the parties requested a stay of Board proceedings. ACF withdrew the disallowance for FFY 05, without prejudice to reinstate it. With respect to FFY 04, the parties' counsel informed the Board in August 2009 that the parties had agreed that by October 12, 2009, Pennsylvania would submit appropriate documentation to ACF, including "receipts and invoices, copies of contracts and other records which both document the actual expenditures and demonstrate that the cash outlays paid for activities that improved the quality of infant and toddler care." ACF Exs. 10, 24. ACF later extended the time period for submission to November 12, 2009, but Pennsylvania did not submit such documentation.

Instead, Pennsylvania sought to support its claim by either –

- spreadsheets prepared with information from the CCIS information system allegedly showing actual expenditures for the rate increases, or, alternatively,
- examples of documentation of provider expenditures for improving quality of care for infants and toddlers under grants made by its CCRDs and summary charts from the CCRD database.

ACF rejected that evidence as inadequate to show that Pennsylvania had allowable expenditures allocable to the FFY 04 I/T earmark in the amounts it says it had and that Pennsylvania had not claimed I/T earmark funds from other years or grant funds from other sources based on those actual expenditures.

Before the Board, Pennsylvania raised numerous arguments, presenting documentation and other evidence both with its initial brief and with its reply brief. The Board permitted ACF to submit a surreply and Pennsylvania to respond to the surreply.

### **Analysis**

We set out and address in detail each of Pennsylvania's major arguments in the numbered sections below. At the outset, however, we note that many of Pennsylvania's arguments mischaracterize ACF's position and authority. Pennsylvania claims that ACF had no basis for finding Pennsylvania misspent funds and is arbitrarily imposing a requirement that a state bear an enormous administrative burden of producing voluminous source documentation, such as invoices and time and attendance sheets, in order to show the state is entitled to I/T earmark funds. This position, Pennsylvania argues, is inconsistent

with the statute, regulations, and congressional intent to give states flexibility in block grant programs.

As we discuss below, Pennsylvania's premises are mistaken. ACF is not establishing some general requirement for production of source documentation, but merely addressing the circumstances here. State accounting records show, and the state auditors found, that FFY 04 I/T earmark funds were applied to expenditures under contracts with Erie County and Federation that did not qualify for the I/T earmark. The fundamental issue raised is whether, in the face of that undisputed evidence showing the funds were spent for non-qualifying purposes, Pennsylvania's evidence is adequate to show it had sufficient other allowable costs, qualifying for the earmark, which were not charged to other grant funds and which therefore may be used as substitute expenditures to avoid Pennsylvania having to repay the earmark funds.

Essentially, Pennsylvania contends that since the documentation it submitted to the Board shows it incurred substantial expenditures to improve the quality of care for infants and toddlers, we should reverse the disallowance or, if we find ACF has raised legitimate concerns, remand the case to ACF to give Pennsylvania another opportunity to show it is entitled to the funds. As we explain below, however, ACF's concerns have been clear to Pennsylvania at least since the Assistant Secretary's reconsideration determination. Despite ample opportunity to address those concerns, Pennsylvania still has left significant issues unanswered. The fundamental problem is that Pennsylvania still has not addressed the concern that Pennsylvania and its grantees had not fully implemented sufficient internal controls, such as monitoring and auditing consistent with federal and state law, to assure the accuracy of data in its systems, either for the CCISs or for the CCRDs. More important, although Pennsylvania says its accounting system codes funding sources to expenditures, Pennsylvania presented no evidence to address ACF's concern that the actual expenditures Pennsylvania now wants to use to justify its claim for FFY 04 earmark funds were not already charged to other federal funds. Indeed, with respect to the CCRD expenditures, Pennsylvania admits in effect they were already charged to other CCDF funds.

Below, we set out our complete analysis, explaining why we uphold the entire disallowance and decline to remand the case to ACF.

### **I. The audit findings and workpapers support a conclusion that Pennsylvania improperly expended I/T earmark funds.**

Pennsylvania argues that ACF has no basis for concluding Pennsylvania improperly expended I/T earmark funds. The state audit and workpapers provide a basis for determining that Pennsylvania misspent FFY 04 earmark funds, however. State records showed the funds being applied to contracts with Erie County and Federation, and state auditors found that the budgets for those contracts contained no line item detail and no

separate commitment document for the I/T earmark funds. Pennsylvania submitted no documentation showing that those contractors in fact incurred any expenditures that would qualify for the I/T earmark, much less that those contractors had over \$3 million in qualifying expenditures. While a Pennsylvania official was able to show the auditors how he determined what amount to record, the state auditors were not able to trace the entries in Pennsylvania's accounting records to any appropriate level of actual expenditures for I/T purposes.

Pennsylvania challenges ACF's reliance on the regulation requiring a state to be able to trace funds to a level of expenditure sufficient to ensure no violation of program requirements on two grounds: 1) that ACF had no broad rulemaking authority; and 2) failure to be able to trace funds is insufficient as a basis for disallowance since it is merely a technical and insubstantial failure.

In our view, the lack of any audit trail to expenditures qualifying for FFY 04 I/T earmark funds is neither technical nor insubstantial. Pennsylvania was required to timely obligate and spend CCDF Discretionary Funds. Thus, it was highly improper for Pennsylvania to continue to report as expenditures amounts supported at most by a spreadsheet estimating what part of the payment increases for SFYs 05 and 06 might be allocable to infants and toddlers. As ACF points out, the report form ACF requires states to use for claiming CCDF funds distinguishes estimates from amounts actually obligated or expended. ACF Ex. 23.

Even assuming the record entries and spreadsheet might be sufficient to show timely obligation of funds for the rate increases (which is questionable), they clearly were insufficient to show timely liquidation of the obligation through actual expenditures – a prerequisite to avoid the funds reverting to the federal government. State policy governs when an amount may be recognized as an expenditure. ACF Ex. 13. Pennsylvania does not allege that the state auditors' rejection of the spreadsheet showing only projected expenditures was inconsistent with state policy.

Pennsylvania premises some of its arguments on its assertion that its treatment of the I/T earmark was approved by the ACF representative with whom the DPW Bureau Director spoke during the week of August 29, 2005. The record, however, does not support a finding that the ACF representative approved what Pennsylvania did. The DPW Bureau Director's supplemental affidavit states:

[The ACF representative] agreed that DPW did not have to re-code numerous line items in the Commonwealth's SAP accounting system in order to designate the additional compensation for the I/T earmark. He agreed that we could use a single contract entry in our SAP system to reflect commitment of the total amount of the rate increases for both years, so long as we could document the expenditures. I

understood that we could document this contract entry by providing supporting detail on budget documents.

PA Ex. 48, ¶ 3. In his contemporaneous email about the conversation, however, the Pennsylvania official noted that “we still have one prior fiscal year where funds were not set up in SAP” and reported that the ACF official said “that as long as we can document our expenditures we do not need to update SAP with 118-150 lines of additional commitments in the IT Earmark Internal Order.” PA Ex. 16 (emphasis added).<sup>4</sup> In the context of Pennsylvania’s need to timely obligate the funds, this indicates at most that ACF approved Pennsylvania using some summary mechanism to record the obligation of the I/T earmark funds in the accounting system. We find it does not indicate approval of the particular method Pennsylvania used, i.e., identifying the funds with the Erie County and Federation contracts. Moreover, Pennsylvania could not reasonably rely on the ACF representative’s statement as meaning that Pennsylvania would not have to meet the requirements regarding obligation of funds or the federal and state requirement that it be able to trace CCDF funds on the accounting records to an appropriate expenditure level. Indeed, in a June 2007 email to the ACF official, the DPW Bureau Director referred to the contact in 2005, saying the official “thankfully said that I just needed to have an audit trail.” PA Ex. 21, 5<sup>th</sup> page. Such an audit trail to appropriate, I/T expenditures is exactly what was lacking, however.

Pennsylvania could not have reasonably thought that it had approval from ACF to record expenditures incurred by Erie County and Federation as charged to the FFY 04 earmark, and then support that charge only by a spreadsheet showing projected amounts for rate increases to 59 CCISs. Pennsylvania’s own evidence shows that the ACF representative said Pennsylvania must have an audit trail and must be able to document its expenditures. Moreover, the DPW Bureau Director did not state that he told the ACF representative exactly what he intended to do. Instead, he attested that he “understood” from the conversation that Pennsylvania “could document this contract entry by providing supporting detail on budget documents.” PA Ex. 48, ¶ 3. Yet, the state auditors found that the budgets for the Erie County and Federation contracts identified in the accounting records did not include any line item detail for I/T, and Pennsylvania has produced no documentation showing any supporting detail on budget documents for any of the 59 CCISs. This is significant because, absent budget detail showing that the rate increases

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<sup>4</sup> Pennsylvania does not provide an explanation of what “SAP” means. The record does indicate, however, that the DPW Bureau Director, on September 14, 2005 requested assistance “in transferring expenditures in the 988 CCDFBG-Day Care appropriation in order to satisfy the federal earmarking requirement for Infant and Toddler.” PA Ex. 20, at 7. He identified two accounts from which amounts for Erie County were to be transferred to the FFY 04 I/T earmark account (for \$1,335,698 and \$928,486) and one account from which an amount for Federation was to be transferred to the earmark (for \$1,482,696). *Id.* The state audit workpapers include printouts from state records showing “actual expenditures” in those amounts being posted to Erie County and Federation. *Id.* at 4.

for infants and toddlers were to be funded by the I/T earmark, the CCISs would not know not to charge those rate increases to other funds.

We also see no merit to Pennsylvania's argument that the regulatory requirement that states be able to trace funds to an appropriate level of expenditure is invalid because the Secretary had no broad grant of rulemaking authority under the CCDBG Act. The CCDBG Act required states to submit reports about their expenditures and to have independent audits each year. It is hard to see how they could meet these requirements and show that they met the statutory restrictions on funding without being able to trace funds to actual expenditures.

Moreover, the Secretary had authority under section 1102 of the Social Security Act to promulgate regulations to provide for the efficient administration of section 418 of that Act (which authorizes the Mandatory and Matching Funds and allows transfer of TANF funds to the Discretionary Fund). The Secretary reasonably determined that, to provide for the efficient administration of section 418, the Secretary could promulgate a rule requiring that states be able to trace all CCDF funds to expenditures. Absent such a requirement, it would be impossible to determine whether the funds met statutory restrictions and were spent according to congressional intent.

Finally, we reject Pennsylvania's argument that the undisputed audit findings are insufficient as a basis for disallowance because the auditors only "questioned" the expenditures and "there are no specific findings of expenditures inconsistent with the CCDF statute." PA Final Br. at 5 (text and n.4). Pennsylvania's own definition of "questioned costs" for audit purposes encompasses costs that are questioned because of "an audit finding that occurred . . . from a violation of a provision of a law." ACF Ex. 13, at 6. Congress restricted use of I/T earmark funds. The audit findings and workpapers support a conclusion that Pennsylvania improperly expended those funds for non-earmark purposes.

## **II. Pennsylvania's documentation of substitute expenditures is not reliable.**

Pennsylvania argues that ACF was arbitrary in requiring documentation such as invoices and receipts and rejecting the spreadsheets for the rate increases and the summary charts of CCRD expenditures. In this section, we first address general arguments about this type of documentation. We then address more specifically the two alternative sets of documentation Pennsylvania submitted to show its actual expenditures.

### *A. Spreadsheets or charts from a state database are not per se adequate documentation.*

Pennsylvania points to Appendix I to the manual issued by the Government Accountability Office establishing Government Accounting Standards. Section A7.02 of

Appendix I lists spreadsheets as one type of documentary evidence an auditor may consider. The section goes on, however, to explain what process auditors use “to analyze any evidence to determine whether it is sufficient and appropriate” and that the “strength and weakness of each form depends on the facts and circumstances associated with the evidence and professional judgment in the context of the audit objectives.” As ACF argues, this cannot reasonably be read as requiring ACF to accept such summary documentation as sufficient to support a specific claim without considering the circumstances.

Pennsylvania also argues that the databases from which the spreadsheets and summary charts were derived are used by it as a basis for payment to the subgrantees and therefore should be acceptable as records kept in the regular course of business. Pennsylvania submitted no evidence that the undated summary charts were kept in the regular course of business as a basis for payment of I/T earmark funds, however, and Pennsylvania’s evidence shows the spreadsheets were created for these proceedings. Moreover, even if we considered them to be business records, that would at most mean they were admissible under normal rules of evidence, despite the hearsay rule. It would not by itself establish that the evidence is reliable. Finally, Pennsylvania’s own policy based on Generally Accepted Accounting Principles distinguishes the original documentation of a transaction from summary records. ACF Ex. 12, at 3.

Perhaps in recognition of this, Pennsylvania now argues that the spreadsheets and summary charts should be considered source documentation. We disagree. The spreadsheets and summary chart clearly are not the type of documentation that evidences the transactions recorded in the state systems such as payments to child care providers, but are merely printouts of data compilations derived from information entered into the system, supposedly based on the original source documents. *Id.*; *cf.* 45 C.F.R. § 92.20(a)(5)(referring to “such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subaward award documents, etc.”).

*B. Pennsylvania’s spreadsheets of CCIS rate increase amounts are not reliable evidence that the expenditures were allowable and allocable to the earmark.*

Pennsylvania Exhibits 32 and 33 are the spreadsheets on which Pennsylvania relies to show what part of the actual payments for rate increases in SFYs 05 and 06 were for infants and toddlers. These spreadsheets were not generated from any state accounting records, but were generated by a Project Manager for Deloitte Consulting, LLP (Consultant) from data in Pennsylvania’s Child Care Management Information System (CCMIS). With its reply brief, Pennsylvania submitted a declaration from the Consultant, explaining the electronic system from which she derived the data and what she did to generate the spreadsheets in April 2010. PA Ex. 49.

The Consultant explains that the system is a “centralized repository that includes data on children eligible for child care subsidies, providers eligible to receive those subsidies, subsidy rates paid to providers, authorized days and actual number of days attended for each child, and subsidy payments made to providers.” *Id.* ¶ 2. The data for each child “includes date of birth, age classification, and child care provider.” *Id.* The data on attendance “originates from forms submitted by providers” to CCISs. *Id.* The Consultant says: “I believe that CCIS personnel enter the invoice data into the [CCMIS] system and retain the hard copy forms at the CCIS” and that “both DPW and the CCISs are able to access information in the [CCMIS] system and monitor the payment process through the system.” *Id.* She does not claim to have any personal knowledge of any monitoring of the system or of the information entered into the system.

With respect to the spreadsheets she generated, the Consultant explains that the first spreadsheet column shows the age category for each child, the “invoice units” column shows the number of days, the “invoice rate” for the year in question (either 2005 or 2006) is the daily rate paid, the “MCCA rate” for the previous year is the maximum child care allowance for the same category of child for that previous year, the “rate delta” is the difference between these two daily rates, and the “extended rate delta” is the “rate delta” times the number of “invoiced units.” *Id.* at ¶ 4. The “extended rate delta,” she says, “represents the additional compensation the provider received for care of infants or toddlers as a result of the year-over-year rate increase.” *Id.*

ACF determined that the spreadsheets were not adequate documentation because the state auditors had found that the CCMIS system was not reliable. The state auditors reported: “We have noted in our testing of the CCMIS that DPW’s on-site monitoring of CCIS front-end child data entry is deficient in that monitoring visits by state officials are limited and activities performed by these officials are not well documented . . . .” PA Ex. 20, at 1. The auditors also noted that “our review of DPW’s CCIS Agency Audit Guidelines for Fiscal Year 2005-2006, . . . which provides overall guidance to OMB Circular A-133 subrecipient auditors, does not require submission or auditor testing of detailed subrecipient reports to support infant and toddler earmark expenditures.” *Id.*

Elsewhere in their report, the state auditors explained that DPW implemented the CCMIS as of July 1, 2005, and uses it for cash payments under both the CCDF program and the Social Services Block Grant program. PA Ex. 19, 4<sup>th</sup> page. The state auditors reported that SFY 06 was a start-up year for implementation of DPW’s monitoring tool for the CCISs, that only four of the 59 CCIS agencies were monitored on-site while the remainder were monitored through a self-assessment process with an on-site visit by a subsidy coordinator, that “neither the four on-site visits nor the on-site visits by the subsidy coordinators were supported by written documentation evidencing their review activities,” and that the self-assessment document was not available for each CCIS. *Id.*

Pennsylvania disputes these audit findings. Pennsylvania does not claim that the CCIS audit guidelines required submission of any detailed subrecipient reports to support earmark expenditures, nor did Pennsylvania submit any documentation to show the results of any CCIS monitoring visits. Instead, Pennsylvania points out that the CCIS Agency Audit Guidelines for SFY 06 do require auditors to “[t]race a sample of provider invoices submitted to the CCIS to the provider’s supporting documentation to verify that the number of service days/attended days was properly reflected” and “[t]race a sample of payment summaries and actual payments submitted to the provider to the attendance invoice completed by the provider to the CCIS” and “[v]erify that the number of paid days (enrolled service days/attended days) was properly reflected.” PA Ex. 20, at 13-14.

This is not sufficient to overcome the state auditors’ conclusion that the compiled data are not reliable, however. First, even assuming that auditors of the CCISs followed the audit guidelines for SFY 06 and tested whether invoice amounts matched the attendance reports, Pennsylvania does not argue that CCIS auditors tested the data entry regarding the birth date of each child – and therefore whether the child fell into the infant and toddler category – and found that data to be accurate. Pennsylvania suggests that there would be no incentive for misreporting this information, but its own spreadsheets show that the payment rates were higher for infants and younger children. PA Exs. 32, 33.

Second, Pennsylvania provided no evidence of results of any CCIS auditor testing showing that there were no significant errors in the invoices reporting CCIS payments or in entering that data into the information system.

Third, even assuming that the audit guidelines provided some assurance of the reliability of the system data for SFY 06, that would not address the reliability of the data with respect to actual expenditures for rate increases for SFY 05. The record shows both that the monitoring had not been implemented in that year and that the CCMIS system was not implemented until July 1, 2005, which makes it more likely that data entry errors would be made and not corrected for SFY 05 (which ended on June 30, 2005).

As we discuss below, nothing in the CCIS audit guidelines gives any indication that CCIS auditors were providing any oversight of what amounts of actual expenditures, if any, a CCIS was claiming qualified for the I/T earmark. In fact, the audit guidelines have a section for “Matching, Level of Effort, and/or Earmarking Requirements” which states only that there are no matching requirements and does not even mention the I/T earmark. PA Ex. 20, at 14. The audit guidelines also note that the “CCIS funding sources and amounts are located in CCMIS,” but Pennsylvania’s spreadsheets from the CCMIS system do not identify a funding source for the rate increases. PA Ex. 20, at 19; PA Exs. 32, 33.

Pennsylvania suggests that concerns about the reliability of the data could be readily addressed because the Consultant attested that an auditor could use a computer terminal

to check “screen shots containing information on an individual child or detail on the number of days for which a provider was paid for care of that child during a particular month, or to conduct other cross checks.” PA Ex. 49, at ¶ 5. Pennsylvania does not explain how computer cross checks would address concerns about whether data were entered correctly and adequately supported. Indeed, the Consultant’s statement indicates that she knew this would not be sufficient to verify the information since she goes on to refer to possible review of the attendance forms. *Id.*

Pennsylvania does with its reply brief submit documentation tracing one payment (from a CCIS to a provider) to the total of amounts on two provider payment summaries (apparently printed out on 06/14/10) and a supporting “Child Care Attendance Invoice” for one the summaries, which contains a provider signature on a statement certifying that the information is correct. PA Ex. 46. The exhibit also includes an excerpt from the spreadsheets. The client identification number (50169298) and invoiced amount (\$243.20) for one entry on the spreadsheet excerpt allows us to trace that entry to the invoice. The “extended rate delta” (i.e., increased payment amount) for that entry is only \$19.20. Pennsylvania suggests that a valid statistical sample of supporting documentation might be sufficient to establish it had enough qualifying expenditures for the I/T earmark, but one set of supporting documents is not such a sample.

Pennsylvania also points out that the spreadsheets show over \$7 million as the “extended rate delta” total for the two years. Since this is so much in excess of the \$3.1 million earmark amount at issue, Pennsylvania suggests that the spreadsheets should be sufficient to support the earmark, even if there were some data entry or other system problems. This argument ignores the fact, discussed below, that neither the spreadsheets nor any other documentation in the record shows that Pennsylvania has not already claimed payments for the rate increases as expenditures under another fund or grant program.

*C. Pennsylvania’s documentation for CCRD grants is inadequate to show the amount of actual expenditures allocable to the I/T earmark.*

Pennsylvania also submitted charts of SFY 05 grants awarded by CCRDs to child care providers for quality improvement, indicating the purposes of the award and allocating amounts between “Infant/Toddler” and “Other.” PA Exs. 34 and 35. These exhibits do not include any total of the awards, but Pennsylvania subsequently submitted replacement pages showing the total amounts recorded on each chart for the amounts allocated to the “Infant/Toddler” categories. PA Ex. 47. The total for the two charts is \$1,444,777.21 – far less than the \$3.1 million earmark.

These charts on their face show amounts awarded by the CCRDs to the providers. The charts do not purport to show actual expenditures for the purposes recorded. Moreover, while Pennsylvania’s exhibit index describes Exhibit 36 as “DPW Chart Documenting Infant and Toddler Expenditures by Region from January 2004-June 2004,” this chart at

most documents the total number of infants and toddlers by region for SFY 04 and does not support any conclusion about actual expenditures for SFY 05. Pennsylvania nonetheless asks us to accept its summary charts as showing actual I/T expenditures because it has submitted four sets of supporting documentation.

The first set is Pennsylvania's documentation it says it submitted to show that the information on its data system for the CCRDs can be tracked to actual expenditures. Pennsylvania Exhibit 37 includes an excerpt of a printout from the data system (KIDS database) of expenditures in the Northwest Region, a KIDS database printout of expenditures by a particular day care home and a grant summary for that home, and KIDS database expenditure detail for that home showing a \$9.99 expenditure for a "Diaper genie and bag." As ACF pointed out, all of this documentation relates to an expenditure in SFY 07. Thus, it is not relevant to the accuracy of information in the KIDS database in SFY 05. Indeed, there is no documentation in the record that the database even included actual expenditures in SFY 05, since the charts in Exhibits 34 and 35 show only amounts awarded. This is not surprising since Pennsylvania acknowledged that the necessary changes to the state's computer and other systems to provide detail sufficient to show I/T funds were used for earmark purposes at the provider level were not implemented until SFY 06. ACF Ex. 9, at 1; *see* PA Final Br. at 4 n. 3.

The other three sets of documents relate to actual expenditures in SFY 05 (although the amounts spent in any category are not always equal to the amounts for that category in the approved budgets). Pennsylvania attacks ACF's reasons for rejecting these documents. Even accepting them as documenting that some of the providers did have actual expenditures for I/T purposes, however, they are certainly insufficient to show that all of the entries on the charts reflect actual, allowable expenditures. Therefore, they do not show that Pennsylvania had allowable expenditures in the amount of the \$1,444,777.21 total awards for I/T purposes shown on the two charts.

Moreover, there are other reasons for rejecting the charts as establishing the amount of allowable I/T expenditures in SFY 05. As discussed above, the state auditors found that Pennsylvania did not timely implement monitoring of the expenditures. Also, ACF's reviews of the expenditures Pennsylvania said justified its claims for other years showed that unallowable costs, such as construction costs, and unallocable amounts were included. Also, as we discuss below, since Pennsylvania has already claimed other CCDF funds for the CCRD expenditures, reversing the disallowance here would result either in duplicate payment of federal funds for the same expenditures or the need for Pennsylvania to return the other CCDF funds it previously claimed on the basis of the expenditures.

Pennsylvania seeks to undercut ACF's reliance on Pennsylvania's failure to timely implement its corrective action plan by pointing out that ACF never formally approved that plan. Section \_\_.315 of the Attachment to OMB Circular A-133, however, requires

an auditee to develop and implement a corrective action plan in response to adverse audit findings, and requires auditors to follow up on such findings until they are fully corrected, as the state auditors did here. Thus, Pennsylvania had a duty to act to correct its lack of sufficient internal controls. No formal approval by ACF was required, nor does the lack of such formal approval matter here. What matters is that Pennsylvania's failure to take steps to ensure that adequate monitoring was done undercuts its position that its system data are reliable.

While Pennsylvania says it did do some monitoring, it submitted only one example of an on-site monitoring review report by one of the CCRDs. This evidence is clearly inadequate. It is a one-page report indicating that the CCRD did 92 on-site visits of 319 grantees receiving quality improvement grants and found one grant for \$1,250 was not spent appropriately. PA Ex. 45. The report does state: "Grant and award funds were verified by paid receipts, other forms of documentation such as: verifying payments to staff and or vendors, trainers and or visual verification with large purchases such as playground equipment." *Id.* Since it also says that the "reviews were done randomly," it suggests that the reviewers verified only a sample of payments, but there is no information in the report from which we could determine the methodology of the review or the significance of the finding that \$1,250 was misspent. Nor is there sufficient information for us to tell whether this expenditure was included on the summary charts as an award for I/T purposes or whether the reviewers verified that amounts awarded for I/T purposes did in fact benefit infants or toddlers.

### **III. The issue is the adequacy of the documentation submitted to us, rather than whether ACF could reasonably establish a blanket requirement for production of source documentation.**

Pennsylvania asserts that ACF is imposing a draconian requirement that a state must produce source documentation and that that position is unreasonable and inconsistent with the statute and regulations. ACF is not here establishing a blanket requirement for such production, however, but only saying what it would find adequate in the circumstances of this case to show that Pennsylvania had expenditures it can substitute for the expenditures it recorded as earmark expenditures and the state auditor questioned.

Despite state audit findings regarding Pennsylvania's failure to properly monitor the I/T earmark, ACF undertook documentation reviews to resolve the audit findings. For the FFY 04 earmark, ACF agreed to review source documentation if Pennsylvania produced it. Pennsylvania agreed to provide the source documentation by October 12, 2009, but did not do so. ACF offered Pennsylvania until November 13, 2009 to provide the documentation, but Pennsylvania still did not submit the source documentation. Nor did Pennsylvania submit any source documentation to us other than for one payment by a CCIS and for a few grants made by CCRDs.

Pennsylvania now says ACF should have reduced the administrative burden on Pennsylvania, consistent with the intent of Congress, by testing a statistical sample of documentation. But, Pennsylvania does not allege it proposed use of a statistical sample to ACF during negotiations, nor did it provide documentation from a valid statistical sample to us. Board procedures state that, where submission of all relevant documents would lead to a voluminous appeal file, the Board will consult with the parties about how to reduce the size of the file. 45 C.F.R. § 16.8(e). Yet, Pennsylvania did not here seek assistance from the Board to reduce the size of the file, instead deciding on its own what documentation to produce.

The Board is ultimately charged with evaluating whether the documentation submitted establishes that Pennsylvania is entitled to retain the I/T earmark funds. Our conclusion that the documentation is insufficient does not arise from any blanket requirement that Pennsylvania produce source documentation for every earmark expenditure. Rather, it results from Pennsylvania's failure, in the face of negative audit findings and despite being offered multiple opportunities, to offer any reasonable, reliable basis on which we could conclude what amount of actual expenditures in fact benefited I/T earmark purposes.

**IV. There is no adequate assurance that allowing Pennsylvania to retain the FFY 04 earmark funds would not result in duplicate reimbursement for those expenditures or otherwise result in a failure to meet the statutory restrictions.**

We have stated above why ACF's concerns about the documentation to show actual expenditures were incurred for I/T purposes are warranted. Even if those concerns were unwarranted, however, we would uphold the disallowance for other reasons.

In addition to questioning the reliability of the data on which Pennsylvania now relies to show actual expenditures for the rate increases, ACF has consistently said that it has no assurance that other grant funds were not claimed for these actual expenditures. Pennsylvania does not adequately address that concern.

The DPW Bureau Director's Supplemental Declaration says Pennsylvania "attaches a code to each federal dollar in its system to ensure that each grant dollar is applied to only one federal grant (or earmark). After [ACF] approved use of the rate increases for the FFY 2004 I/T earmark, I arranged for the rate increase dollars to be shifted into two contracts and coded as I/T earmark dollars in our SAP accounting system. These dollars continue to be coded to the I/T earmark. This means that these dollars have not been used for any other purpose." PA Ex. 48, ¶ 11. The issue is not, however, whether the earmark dollars were spent for purposes other than the contracts to Erie County and Federation to which the auditors traced the claim. The issue is whether or not the expenditures, in the form of actual payments to the 59 CCISs for the rate increases, on which Pennsylvania now relies to support its claim were the basis for claims for other

funds (either CCDF funds or some other grant funds, such as the Social Services Block Grant funds the record indicates CCISs were receiving).

The auditor workpapers show that the FFY 04 earmark funds were identified in state accounting records as having been applied to the expenditures for two Erie County accounts and one Federation account, which the state auditors found were for contracts that did not have any amounts budgeted for I/T. Pennsylvania did not challenge the audit findings. Nor has Pennsylvania submitted any documentation showing any kind of notation in its accounting system or elsewhere that would have precluded CCIS expenditures for the rate increases from being charged to other funds. Notably, the DPW Bureau Director says in his Supplemental Declaration that Pennsylvania did not use the rate increases in SFYs 05 and 06 to “satisfy the I/T earmark for any year except FFY 2004,” but he does not assert that the actual rate increases were not part of a claim for funds from other sources. PA Ex. 48, ¶ 11.

Pennsylvania in footnote 3 of its final brief now says:

ACF also complains that DPW has not adequately explained how its internal coding of expenditure would prevent the use of earmark dollars for other federal grants. . . . For accounting purposes, DPW assigned the projected rate increase dollars to CCIS contracts for several counties. Once this assignment was made, that amount continued to be coded to the I/T earmark when the actual rate increase dollars were paid, and only any remaining portion of the contract amount for that CCIS (which was capped) could be coded for purposes other than the I/T earmark. DPW is prepared to review with ACF staff its assignment of expenditures to various grant categories if ACF believes this point is worth pursuing.

(Emphasis added.) This statement also confuses the issue. The issue is not use of the earmark dollars for other federal grants. Rather, the issue is whether the actual expenditures for rate increases that Pennsylvania now seeks to use to justify its claim for the FFY 04 I/T earmark funds were claimed as expenditures justifying receipt either of earmark funds for other years or of non-earmark funds under the CCDF or another program. Pennsylvania may not be reimbursed twice for the same expenditures.

Also, Pennsylvania seems to be admitting that the dollars it received under the FFY 04 earmark were not allocated to cover the actual expenditures it now claims it had, but were assigned only to CCIS contracts with “several counties” (presumably Erie County and perhaps Federation), with the amount determined by the projected increases. Even if this “assignment” to the I/T earmark meant other funds would not have been claimed to cover

expenditures for any rate increases under those few contracts, Pennsylvania seeks here to use rate increases distributed by 59 CCISs, not just the “several counties.”<sup>5</sup>

With respect to the alternative of reversing part of the disallowance based on the documentation of CCRD grant awards, the potential for duplicate payments is even greater. The DPW Bureau Director’s Supplemental Declaration says that in developing its charts, Pennsylvania “pulled from our database only STARS quality expenditures that were coded as FFY 2004 CCDF dollars” and “[i]f DPW were to code these STARS dollars for the I/T earmark and remove that code from the rate increase dollars, the STARS grant dollars would be applied only to the I/T earmark, not to any other program or year.” PA Ex. 48, ¶ 12. The main problem with this suggestion is that simply adding and removing codes is not enough. If the \$1,444,777.21 in alleged expenditures were to be charged to the I/T earmark and no longer charged to CCDF non-earmarked funds, then Pennsylvania would have to repay the non-earmarked CCDF dollars it previously claimed based on those expenditures. Pennsylvania would also have to repay the difference between the \$3.1 million earmark and the \$1.4 million in expenditures. In other words, Pennsylvania’s repayment obligation would still be for the entire amount disallowed.<sup>6</sup>

## **V. ACF did not lack statutory authority to disallow CCDF Funds.**

### *A. The statute contains two separate procedural provisions.*

As Pennsylvania acknowledges, the CCDBG Act sets out two procedures that ACF may use to recoup funds from states or to impose monetary penalties upon them – the enforcement procedures at 42 U.S.C. § 9858g and the audit procedures at 42 U.S.C. § 9858i.

Section 9858g provides:

If the Secretary, after reasonable notice to a State and opportunity for a hearing, finds that—

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<sup>5</sup> Pennsylvania may be suggesting that Erie County and Federation had allowable I/T expenditures, but there is no basis in the record for establishing the extent of those expenditures. The spreadsheet with projected rate increase payments allocable to I/T, projected a total of only \$30,000 in increased payments under the Erie County CCIS for SFY 05 and \$ 61,123 in increased payments to Erie County CCIS for SFY 06. PA Ex. 20, at 10-11. The spreadsheet does not list Federation as a CCIS. Also, the spreadsheets allegedly showing actual expenditures for the rate increases identify child care providers, but not the CCISs that distributed the subsidy payments. PA Exs. 32, 33.

<sup>6</sup> A further problem could arise if Pennsylvania used the quality expenditures previously charged to non-earmarked CCDF funds to meet the statutory four percent requirement referred to above.

(i) there has been a failure by the State to comply substantially with any provision or requirement set forth in the plan approved under section 9858(c) of this title for the State; or

(ii) in the operation of any program for which assistance is provided under this subchapter there is a failure by the State to comply substantially with any provision of this subchapter;

the Secretary shall notify the State of the finding and shall require that the State reimburse the Secretary for any funds that were improperly expended for purposes prohibited or not authorized by this subchapter, that the Secretary shall deduct from the administrative portion of the State allotment for the following fiscal year an amount that is less than or equal to any improperly expended funds, or a combination of such options.

(Emphasis added.)

Section 9858i contains the requirements for state audits under the Single Audit Act and provides that the Secretary may require a state to—

repay to the United States any amounts determined through an audit under this subsection not to have been expended in accordance with this subchapter, or the Secretary may offset such amounts against any other amount to which the State is or may be entitled under this subchapter..

(Emphasis added.)

Pennsylvania reads section 9858g as meaning that “in order to recoup funds from a State, ACF must find that the State has failed to ‘comply substantially’ with any provision of the statute or its State Plan.” PA Br. at 18. Pennsylvania reads section 9858i as meaning that “funds must be repaid only if the audit has determined that they were not expended consistently with the provisions of the CCDBG Act.” *Id.*

*B. The regulations distinguish disallowance procedures and procedures where there is a finding a state is not complying substantially.*

Pennsylvania acknowledges that the regulations governing the CCDF include a rule setting out disallowance procedures. *Id.* That regulation, at 45 C.F.R. § 98.66, provides that a state may request reconsideration by the Assistant Secretary of a disallowance determination and then appeal to this Board – the procedure that Pennsylvania followed here.

The regulations set out separate procedures for applying penalties and sanctions based on an ACF review finding that a state has failed to comply substantially with the CCDF Plan or with one or more provisions of the CCDBG Act or implementing regulations. 45 C.F.R. Part 98, subpart J, and Part 99. Under those procedures, a state has a right to a hearing in which the presiding officer is the Assistant Secretary or his/her designee. 45 C.F.R. § 99.2. Upon a final determination that a state is not in substantial compliance, the Secretary will disallow the improperly expended funds and/or deduct that or a lesser amount of funds from the administrative portion of a state's allotment for the following fiscal year and may also disqualify the state from receipt of further funds or withhold future funds if a state does not take action to correct the noncompliance. 45 C.F.R. § 98.92. If a state corrects the failure or violation before the penalty is to be applied or if it submits an acceptable corrective action plan, the penalty will not be applied. *Id.*

*C. The appropriate procedures were followed here.*

ACF appropriately followed the disallowance procedures here. First, ACF made no finding that Pennsylvania was failing to comply substantially with the CCDF Plan or with one or more provisions of the CCDBG Act or implementing regulations. Courts have generally recognized the distinction between an audit-based disallowance identifying specific items of past expenditures as unallowable, and a compliance action in which the authority to withhold future funds is invoked in order to bring a state into substantial compliance with program requirements. *Massachusetts v. Departmental Grant Appeals Board*, 698 F.2d 22 (1<sup>st</sup> Cir. 1983); *Georgia Dep't of Medical Assistance v. U.S. Dep't of Health and Human Services*, 708 F.2d 627 (11<sup>th</sup> Cir. 1983); *Illinois Dep't of Public Aid v. Schwieker*, 707 F.2d 273 (7<sup>th</sup> Cir. 1983). Courts will generally defer to the agency's opinion on whether an action is a disallowance or noncompliance proceeding, but that opinion is not conclusive. As Pennsylvania contends, the Third Circuit Court of Appeals has looked behind an action that an awarding agency labeled as a Medicaid disallowance and found that, in substance, it was a noncompliance proceeding involving the overall administration of the Medicaid state plan. *New Jersey v. Dep't of Health and Human Services*, 670 F.2d 1262, 1272 (3d Cir. 1981). This case is distinguishable, however.

Contrary to what Pennsylvania argues, ACF's determination here is not "essentially a challenge to the way Pennsylvania administered its CCDF program." PA Br. at 20. It is limited to Pennsylvania's past failure to comply with a program requirement only with respect to the earmarked funds. ACF did not find any widespread failure by Pennsylvania to properly account for CCDF funds. While the resulting disallowance involves all of the earmarked funds for one year, the reason for this, as discussed above, is Pennsylvania's failure in response to the audit finding to produce adequate documentation showing actual expenditures for I/T purposes and adequate assurance that it did not use other grant funds to cover those expenditures.

Second, ACF did not invoke its authority under section 9858g of the Act and 45 C.F.R. § 98.92 to impose sanctions or penalties on a state that is not in substantial compliance, nor did it need to do so in order to provide an incentive to Pennsylvania to come into compliance. The problem here was caused by Pennsylvania's attempt to use a one-time approach to account for the I/T earmark for one fiscal year by recording the amount of projected rate increases for subsidy payments to only two contractors, pending implementation of measures to properly monitor and account for the earmark using grants to child care providers.

*D. ACF had authority to establish the disallowance procedures.*

Pennsylvania also challenges ACF's authority to establish separate disallowance procedures. Pennsylvania points out that the CCDBG Act authorizes ACF to "establish by rule procedures for (A) receiving, processing, and determining the validity of any complaints concerning any failure of a State to comply with the State plan or any requirement of this subchapter and (B) imposing sanctions under this section [the noncompliance provision]." PA Br. at 18, citing 42 U.S.C. § 9858g(b)(3). According to Pennsylvania, however, the "statute contains no broad grant of rulemaking authority that would permit ACF to impose procedures or sanctions different from those described in the statute." *Id.*

That the Secretary was required under one section of the CCDBG Act to promulgate a rule establishing procedures for imposing penalties or sanctions based on a finding that a state failed to comply substantially does not mean that the Secretary was not authorized to establish by rule a procedure for taking a disallowance where no such finding was made. A rule granting a state more administrative process than required does not impose a substantive obligation on a state or diminish rights it otherwise has and thus is not a legislative rule requiring rulemaking authority. *See, generally, Kenneth Culp Davis, Administrative Law Treatise* § 7.8 (2d Ed. 1979) and cases cited therein.

As indicated above, section 9858i of the statute provides that the Secretary may require a state to repay amounts determined through an audit not to have been expended in accordance with the CCDBG Act.

Pennsylvania nonetheless argues that the "fact that Congress expressly provided two mechanisms for recouping CCDF funds, and described specifically the procedures and required findings for each, strongly suggests that it did not intend to authorize ACF to use other procedures or grounds for recoupment." PA Br. at 19. According to Pennsylvania, this is particularly so because the CCDF is a block grant program. In support, Pennsylvania cites the regulations at 45 C.F.R. §§ 96.50 and 98.1(a)(1) and the Board's decision in *Pennsylvania Dirs. Ass'n for Cmty. Action*, DAB No. 1482 (1994).

This argument has no merit. First, section 9858i applies to amounts determined through an audit not to have been expended in accordance the CCDBG Act. ACF reasonably determined that this provision applies if a state audit found a state did not expend funds in accordance with the earmark restriction on CCDF funds in an appropriation law.

Second, contrary to what Pennsylvania asserts, section 9858i does not specifically describe any procedure for appeals of disallowances pursuant to audit. Thus, providing a procedure by regulation for those appeals is consistent with the statute, even if that procedure is different from the procedure required by statute when, pursuant to a review, ACF finds that a state is not complying substantially with program requirements.

Pennsylvania's argument that ACF's position is inconsistent with the fact that the CCDF is a block grant program is also misplaced. The regulation at 45 C.F.R. § 96.50(e) that Pennsylvania cites applies to the block grant programs listed in 45 C.F.R. § 96.1. That list does not include the CCDF program. Similarly, the cited Board case addressed a block grant program listed in section 96.1, the Community Services Block Grant.

The cited regulation at 45 C.F.R. § 98.1(a)(1) applies to the CCDF, but refers only to allowing a state "maximum flexibility in developing child care programs and policies that best suit the needs of children and parents within [such] state." Similarly, the House Report on PRWORA that Pennsylvania submitted with its reply brief refers to affording states "much greater flexibility in targeting child care assistance . . . ." PA Ex. 43, 2d page. We see no inconsistency between these provisions and ACF's regulations distinguishing the procedures for imposing sanctions and penalties based on noncompliance reviews and the procedures for disallowances. The distinction between the two types of actions is reflected in the CCDBG Act and does not interfere with state flexibility in developing a child care program and policies pursuant to the Act.

The House Report does also speak about the Budget Committee's proposal to change the "categorical language of current law that requires States to spend fixed percentages of funds on specific activities," explaining that, under the committee proposal, "more money is devoted to actually paying for child care and States are given more flexibility over the smaller amount of money set aside for improving the quality of child care." *Id.*, 3<sup>rd</sup> page. Pennsylvania does not allege that the committee proposal being addressed was enacted into law, however. In any event, by later placing a restriction on appropriated funds, earmarking some of them for the specific activity of improving child care for infants and toddlers, Congress itself limited state flexibility in how those funds may be spent.

Pennsylvania's reliance on the Senate Report on the 1998 appropriations bill at Pennsylvania Exhibit 44 is also misplaced. As Pennsylvania argues, the Senate Committee on Appropriations urged the agency "to provide the States with sufficient flexibility and discretion to administer" CCDF funds, to "work to ensure there are no increased administrative burdens or costs for States and no concomitant reduction in the

resources available for child care and in the ability of States to fully respond to their unique circumstances and needs,” and “to consider the removal of certain administrative burdens, including the requirement that the discretionary portion of the [CCDF] be reported under a different [catalog] of Federal domestic assistance number than the other portions of the CCDF.” PA Ex. 44, 5<sup>th</sup> page. Despite this hortatory language in the Committee report, however, Congress has not acted to override the CCDF regulations, which have been in place since 1998.

### **Conclusion**

For the reasons stated above, we uphold the entire disallowance and decline to remand this case to ACF.

\_\_\_\_\_  
/s/  
Leslie A. Sussan

\_\_\_\_\_  
/s/  
Constance B. Tobias

\_\_\_\_\_  
/s/  
Judith A. Ballard  
Presiding Board Member