

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

Strategic Community Services, Inc.
Docket No. A-10-50
Decision No. 2333
September 27, 2010

DECISION

Strategic Community Services, Inc. (SCSI) appealed the March 25, 2010 decision of the Substance Abuse and Mental Health Services Administration (SAMHSA) disallowing \$36,329.38 in reimbursement paid to SCSI in fiscal years 2008 and 2009 (FY08, FY09) and denying SCSI's reimbursement request of \$3,500 for the period April to August 2009. The costs were claimed for the compensation of the Project Director of a Drug Free Communities (DFC) grant. SAMHSA disallowed these costs based on its determination that the Project Director was an officer of SCSI and its President's brother and was hired in violation of conflict of interest requirements in federal regulations, the Health and Human Services (HHS) Grants Policy Statement, and SCSI's policies. SAMHSA also determined that SCSI's hiring the Project Director as a consultant rather than an employee violated federal regulations and the terms of the grant.

For the reasons explained below, we uphold the disallowance in full.

Case Background

The following facts appear from the record and are undisputed. The record consists of the submissions filed by the parties and the transcript of an informal conference conducted pursuant to 45 C.F.R. § 16.10.

SCSI is a non-profit organization incorporated in Maryland that operates federally funded programs, including a DFC grant in Broward County Florida.

Funds to promote drug free communities are authorized by the Drug Free Communities Act of 1997. 20 U.S.C. § 7101 *et seq.* SAMHSA awarded a DFC grant to SCSI for a five-year project period beginning September 30, 2007. SAMHSA Att. L at 1. The grant, as approved for FY08, included a "Project Director" who was to be an employee of SCSI. *Id.* at 8. SCSI hired Jon Quinton as the Project Director, but as a consultant rather than as an employee.

In a March 25, 2010 letter to SCSI, SAMHSA stated that amounts charged to the grant for payments to Jon Quinton were unallowable. SAMHSA explained:

. . . SCSI's contract with [Jon Quinton] violates federal regulations at 45 C.F.R. 74.42 . . . and is unallowable. When SCSI contracted with Mr. Quinton to serve as Project Director for the SAMHSA Grant, he concurrently served as an officer of SCSI while his sibling, Sylvia Quinton, served as SCSI's President. Additionally, the contract was noncompliant with the HHS Grants Policy Statement Section II-7 *Standards of Conduct for Recipient Employees* prohibiting conflicts of interest when federal funds are used. Finally, the contract with Mr. Quinton did not conform to SCSI's own Conflict of Interest policy that prohibits such contractual relationships.

In addition, SCSI did not follow the DFC year one grant budget when the Project Director position, approved under the category of a Personnel activity, was identified as a contractual activity on its reimbursement request.

SAMHSA Att. J at 1.

Analysis

As the Board has repeatedly held, under the applicable regulations and cost principles, a grantee bears the burden of documenting the existence and allowability of its expenditures of federal funds. *Benaroya Research Institute*, DAB No. 2197 (2008) (citing cases); 45 C.F.R. §§ 74.21; 74.50-74.53; 2 C.F.R. Part 230 Att. A ¶ A.2.g.

A. SCSI's hiring Jon Quinton, who was an officer of SCSI and the brother of the President of SCSI, violated conflict of interest standards set forth in federal regulations, the HHS Grants Policy Statement, and SCSI's policies.

1. The record as a whole shows that Jon Quinton was an officer of SCSI.

SCSI denies SAMHSA's assertion that Jon Quinton was an "officer" of SCSI in FY08 and FY09.¹ SAMHSA Att. J at 1; SCSI Br. at 13. In support of its assertion, SAMHSA submitted copies of reports that SCSI filed with the Florida Division of Corporations. SCSI does not dispute that reports show the following.

¹ The parties have not been specific about whether they are disputing Jon Quinton's status as officer on the Board of Directors or as an officer of the corporation. Nevertheless, for purposes of this decision, it does not matter because the question at issue here is whether he was in a position, as an officer of the Board or the corporation, to influence SCSI's hiring, compensation, and supervision processes so as to create a conflict of interest or the appearance of a conflict of interest.

- In 2001, SCSI filed, as a Maryland corporation, an “Application by Foreign Not for Profit Corporation for Authorization to Conduct its Affairs in Florida” and a “Certificate of Existence.” SAMHSA Att. T at 1 (unnumbered). On that application, SCSI identified four “Directors” and three “Officers” including Sylvia Quinton as “President” and Jon Quinton as “Secretary.” *Id.* at 3. The application was signed by Sylvia Quinton as President. *Id.*
- Thereafter, in 2002 through 2008, SCSI filed annual reports with Florida that listed Sylvia Quinton as President and Jon Quinton as Secretary of SCSI and two of the four “Directors” listed on the 2001 form.² These reports were all signed by Jon Quinton.
- On December 16, 2009, after SAMHSA informed SCSI that it was disallowing costs based on the Florida reports (SAMHSA Att. S), SCSI filed a form with Florida titled “2009 Not-For-Profit Corporation Reinstatement” on which it changed its corporate officers: a Ms. Dallas was identified as replacing Sylvia Quinton as President, and a Mr. Payne was identified as replacing Jon Quinton as Secretary. SAMHSA Att. T at 15.

SCSI denies that Jon Quinton was ever an officer of SCSI. It asserts:

SCSI did not consult legal counsel prior to submitting the Florida application, and erroneously listed Jon Quinton as the secretary of SCSI on the Florida filing. You should know that Jon Quinton never participated in any of the SCSI board or corporate activities.

Tr. at 9. SCSI represents that, in the years after the application was filed, Jon Quinton –

just signed [the Florida form] and sent it, if it required a fee he paid the fee. So Mr. Quinton is not a lawyer, he didn't consult a lawyer, and just didn't see the need to reach out to headquarters before he submitted the forms since it was a very straight forward process.

Id.; see also SAMHSA Att. R at 2 (letter from SCSI Financial Officer to SAMSHA stating that Jon Quinton “has never been a member of the Board of [SCSI]”); SCSI Br. at 10 (stating that SCSI “incorrectly completed” the Florida reports).

To support its assertions, SCSI submitted copies of “Personal Property Return[s]” that it filed with the State of Maryland and “Return[s] of Organization Exempt from Income

² These Directors were a Ms. Parker and a Ms. Williams. SAMHSA Att. T.

Tax” that it filed with the Internal Revenue Service (IRS), none which name Jon Quinton as an officer of the corporation or a Board member. SCSI Atts. D, E.

However, the evidence submitted by SCSI fails to establish that Jon Quinton was not an officer of the corporation, for the following reasons.

Jon Quinton represented he was an officer on six different annual corporate reports filed with Florida in 2002 through 2008. While SCSI states that this was a mistake by Jon Quinton, SCSI's initial Florida filing in 2001, which also represented that he was the Secretary, was signed by Sylvia Quinton as President of SCSI. SAMHSA Att. 3 (unnumbered). At the informal conference, SCSI took the position that Jon Quinton “never participated in any of the SCSI board or corporate activities.” Tr. at 9; *see also* SAMHSA Att. R at 2; SCSI Br. at 10. Sylvia Quinton's 2002 representation to Florida and SCSI's position before the Board cannot both be true. This contradiction undercuts the credibility of SCSI's present representations about Jon Quinton's never having been an officer of SCSI.

The Maryland and IRS forms filed by SCSI also fail to provide a reasonable basis for concluding that Jon Quinton was not an officer of SCSI in 2007, 2008, or 2009 because these forms are both inconsistent and incomplete.

- The Maryland forms and IRS forms are inconsistent with one another and the Florida forms. For example, on the 2007 Maryland form, which requested identification of all “Officers” and “Directors,” SCSI listed four individuals under the "Officers" section.³ SCSI Ex. E. On the 2007 IRS form, which required identification of each person who was an officer or a director at any time in 2007, SCSI listed two of the people identified on the Maryland form and no other individuals.⁴ SCSI Ex. D. Moreover, SCSI did not list Sylvia Quinton as President on either form, even though there is no dispute that she was President of SCSI at all times, and, in fact, signed the forms as "President."
- SCSI did not provide complete information on either form. On the 2007 and 2008 Maryland forms, which requested "Officers" and "Directors," SCSI listed four

³ A Ms. Jones is identified "Chair"; a Mr. Gonzales is identified as "Vice-Chair," a Ms. Cook is identified as "Secretary," and a Ms. Benson is identified as "Treasurer." SCSI Ex. E. At the conference, counsel stated that these people were Board members. Tr. at 18.

⁴ SCSI listed Mr. Gonzales as its "Vice President" and Ms. Cook as its "Secretary." SCSI Ex. D. On the 2008 Maryland form, SCSI listed three "Officers" (Ms. Cook as "President," Ms. Benson as "Secretary," and a Ms. Smith as "Treasurer" and no "Directors.") On the 2008 IRS form SCSI listed, as in 2009, Mr. Gonzales as "Vice President" and Ms. Cook as "Secretary." It listed no other officers or directors, although Sylvia Quinton signed the return as "President."

officers, who were actually Board officers. Tr. at 18. And, while the 2008 IRS form listed two officers and no directors, SCSI represented elsewhere on the form that it had five "voting members on the governing body." SCSI Ex. D, 2008 IRS 990 at Part VI. This indicates that not all Board members were listed on the 2008 IRS form. Again, no corporate officers were listed on either form, even though Sylvia Quinton signed as President.

Therefore, the fact that Jon Quinton is not listed on either the Maryland or the IRS form as an officer is not credible grounds for concluding that he was not an officer since the forms are inconsistent and incomplete and he was listed on the Florida forms repeatedly.

Moreover, we note that SCSI could have submitted other evidence to support its assertions about Jon Quinton's status at SCSI but did not do so. For example, it did not elect to submit testimonial evidence, either by sworn declarations or live testimony, to support its position that Jon Quinton was not an officer. Nor did it submit other records that would document what it claims is its actual (as opposed to reported) governance/management structure. For example, the minutes of the meetings of its Board of Directors for this time period would have shown whether there was an active Board of Directors during the relevant period, the composition of that Board, and how the Board or corporate officers handled business matters, such as the grant application and the hiring of employees and consultants. SCSI's failure to file such testimony and documents reasonably supports an inference that either it had no active Board and the corporation was simply controlled by Sylvia Quinton, and/or Jon Quinton did have a position in the corporate governance structure as SAMHSA concluded and the documents in evidence indicate.

2. SCSI failed to comply with federal conflict of interest requirements and its own conflict of interest policies in hiring an officer and a family member under the DFC grant.

Federal grant recipients are subject to strict conflict of interest requirements designed to prevent the risks created by such conflicts. These risks include the possibilities that conflicts of interest could cause a grantee to not hire the most capable person for a position, to pay for work that is not done or done poorly, or to pay too much for work that is done. Managers of federal grants are responsible for maximizing the effective use of federal funds and must make hiring, compensation, and supervision decisions designed to best fulfill the purposes of the grant. Moreover, "[i]t is not necessary to find that the conflicts of interest adversely impacted the grant in order to uphold the disallowance." *Professional Counseling Resources, Inc.*, DAB No. 2213, at 4 (2008), citing *Bullock County Health Service, Inc.*, DAB No. 360, at 3 (1982) ("While the federal requirements pertaining to less-than-arms-length transactions [at 45 C.F.R. Part 74] were certainly meant to prevent individual pecuniary gain, they clearly also have a broader purpose. Underlying the limitations is the idea that there should be no possibility that decisions

made in management of a grant-supported project could be influenced by conflicts of interest and concerns not related to the best interests of that project.”)

SAMHSA based the disallowance on conflict of interest standards found at 45 C.F.R. § 74.42, made applicable to non-profit grantees by 45 C.F.R. § 74.1(a)(1)⁵; on Section II-7 of the HHS Grants Policy Statement, made applicable to the grant by the terms and conditions of the grant award (SAMHSA Att. L at 3 (unnumbered)); and on SCSI's Conflict of Interest policies (SAMHSA Att. U). SAMHSA Att. J at 2.

Section 74.42 of 45 C.F.R. is captioned “Codes of conduct” and provides, in relevant part, as follows:

The recipient shall maintain written standards of conduct governing the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent shall participate in the selection, award, or administration of a contract supported by Federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, or agent, or any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award. . . . The standards of conduct shall provide for disciplinary actions to be applied to violations of such standards by officers, employees, or agents of the recipients.

The HHS Grants Policy Statement Section II-7 requires grantees -

to establish safeguards to prevent employees, consultants, members of governing bodies, and others who may be involved in grant-supported activities from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private financial gain for themselves or others, such as those with whom they have family, business, or other ties. These safeguards must be reflected in written standards of conduct.

SAMHSA Att. P.

SCSI adopted a Conflict of Interest policy effective 2004. It provided:

No director, officer, employee, or consultant shall use their position for purposes that are, or give the appearance of being, motivated by a desire for private

⁵ In addition, SAMHSA notified SCSI of the applicability of Part 74 in the grant award. SAMHSA Att. at 3 (unnumbered).

financial gain for themselves or others such as those with whom they have a family, business, or other ties.

SAMHSA Att. U (emphasis added).

SCSI hired Jon Quinton, its President's brother and an officer of the corporation, as the Project Director of the DFC grant. There is no information in the record, such as Board minutes, to show that Sylvia Quinton or Jon Quinton recused themselves from the decision-making process that led to SCSI's naming Jon Quinton as the Project Director in the grant application, hiring him as a consultant, and determining his compensation. Nor is there any evidence in the record that shows other steps were taken to make obtaining a Project Director an arms-length transaction.⁶

Moreover, SCSI's action, or nonactions, upon being awarded the grant did not reflect prudent business practices or comply with federal cost principles and, therefore, affirmatively suggest a less-than-arms-length relationship between SCSI and Jon Quinton. Jon Quinton was paid as the Project Director for the DFC grant on a consultant basis as of October 2007. However, SCSI and Jon Quinton did not execute a consultant contract for this position until October 1, 2008, a contract that was then made retroactive to October 1, 2007. SAMHSA Att. V. Under cost principles applicable to non-profit organizations found at OMB Circular A-122, App. B, ¶ 37 (codified at 2 C.F.R. Part 230 and made applicable by 45 C.F.R. § 74.27(a)) the allowability of consultant fees depends on a number of factors including the "[a]dequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions)." 2 C.F.R. Part 230, Att. B, ¶ 37.b.8. The failure to execute a consulting contract for over a year suggests the lack of an arms-length relationship between SCSI and Jon Quinton because, without a contract, SCSI had no written agreement setting compensation, duties, and standards of performance for him.

Representations made by SCSI about Jon Quinton's hiring are not sufficient to establish that his hiring was free of a conflict of interest or the appearance of a conflict of interest. In its brief, SCSI described a multiyear process by which a coalition of organizations in Broward County, Florida "under the leadership of Jon Quinton" applied for a DFC grant.

⁶ We note that the FY08 IRS return required non-profit organizations to answer questions about conflicts of interest. SCSI answered "No" to the question: "Does the organization regularly and consistently monitor and enforce compliance with [its conflict of interest policy]?" SCSI also answered "No" to the following question:

Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision: [1] the organization's CEO, Executive Director, or top management official; and [2] other officers or key employees of the organization?

SCSI Br. at 3-4. The record also contains an email dated February 2, 2010, in which Jon Quinton wrote SAMSHA:

[Sylvia Quinton] did not participate in the selection, award, or administration of the contract because [she is] not the authorized official on the grant, . . . not a member of the board of directors, and . . . affiliated with the parent organization in another state (Maryland) and does not manage the affairs of the organization in Florida.

. . . I organized and supported the coalition for 3 years prior to the coalition becoming a drug free coalition. The leadership of the coalition was transferred to me from another nonprofit in the community (Mount Olive Development Corp.) that had the OJJDP underage drinking coalition. Under my sole leadership, [I] developed the OJJDP underage drinking coalition into a drug free community coalition.

SAMHSA Att. J, at Att. 2.

These assertions do not establish that the process SCSI used in hiring Jon Quinton or in deciding to expand its operations to Florida was free from conflict of interest or the appearance of a conflict.⁷ Specifically, the fact that Sylvia Quinton was not on the Board or listed on the grant or the fact that the grant location is in Florida does not mean that she could not have influenced this process. Indeed, the fact that SCSI did not submit Board minutes reflecting how these decisions were made and the fact that SCSI filed conflicting government documents about the composition of its Board reasonably supports an inference that Sylvia Quinton ran SCSI without meaningful Board participation.

SCSI's assertions that Sylvia Quinton "did not participate in the selection, award, or administration of the SCSI contract with Mr. Quinton" (SCSI Br. at 14) are not credible for at least two additional reasons:

- SCSI represented that, in 2001, it was a technical assistance contractor under a SAMHSA Minority AIDS Initiative (MAI) grant providing assistance "throughout the United States" including to a MAI grantee "in Florida." SCSI Br. at 3. It further represented that it "filed to operate" in Florida in 2001 (where according to the 2001 Florida corporate report Jon Quinton lived) because "leaders in [Broward

⁷ Section 74.42, in addition to addressing conflict of interests in hiring decisions, also addresses conflicts of interest in the administration of a grant. See *Professional Counseling Resources* at 8-10. In this proceeding, SAMHSA alleged that Sylvia Quinton did not remove herself from the administration of this grant and that this failure created such a conflict or an appearance of a conflict. We do not need to reach this question because we uphold the disallowance on other grounds.

County] requested SCSI consultants to assist them to build capacity to provide youth development and youth engagement services” *Id.* at 2. Without any evidence to substantiate the claim that Mr. Quinton’s hiring was part of an arms-length process, it is not credible that SCSI’s decision to apply for a grant that designated its President’s brother as the grant’s Project Director in that distant location was unrelated to that familial relationship and that Sylvia Quinton would not have participated in that decision.

- Further, SCSI’s initial FY08 grant application included Sylvia Quinton as the grant’s “Authorized Representative.” SCSI Ex. A. After this aspect of the grant application was questioned by SAMHSA in the grant review process, Antionette McMullen, SCSI’s Chief Financial Officer, was substituted as Authorized Representative. *Id.* This sequence of events, however, indicates that Sylvia Quinton did participate in SCSI’s decision to apply for a DFC grant in Florida in which her brother was named Project Director.

Finally, SCSI pointed out that SAMHSA was aware of the familial relationship before approving the grant. SCSI Br. at 6. However, the fact SAMSHA was aware that SCSI proposed in the grant application to hire its President's brother for the Project Director position does not absolve SCSI from its responsibility to document that the eventual hiring was an arms-length transaction free from Sylvia or Jon Quinton's influence. Moreover, SCSI did not argue that SAMHSA, at the time of the grant award, was aware that Jon Quinton was identified on Florida corporate reports as the Secretary of the corporation, which is another reason why we conclude there was at least an appearance of a conflict of interest. In addition, SAMHSA did not know at the time that SCSI would hire Jon Quinton as a consultant, rather than as an employee, a change that, as discussed below, violated federal cost principles.

B. SCSI violated OMB Circular A-122 by hiring Jon Quinton, an officer of SCSI, as a consultant.

As SAMSHA argued, consultant payments to an officer of a corporation are not allowable under OMB Circular A-122, which sets forth cost principles for non-profit organizations. SAMHSA Response Br. at 15. As to the allowability of "professional services," those cost principles provide:

Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the non-profit organization, are allowable, subject to subparagraphs b and c when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.

2 C.F.R. Part 230, App. B, ¶ 37.1 (emphasis added).

SCSI hired Jon Quinton as a consultant. SAMSHA Atts. O at 1 (unnumbered); V. Because he was an officer of SCSI at the time he was hired as a consultant, this arrangement violated 2 C.F.R. Part 230, App. B, ¶ 37.1. Therefore, these costs are not allowable. *See Kansas Advocacy & Protective Services*, DAB No. 2079, at 15-16 (2007) (disallowing costs associated with the hiring of an officer of the Board of Directors as a consultant).

C. SCSI violated Part 74 by hiring a Project Director for the DFC grant in FY08 as a consultant without first obtaining SAMHSA's prior approval.

In disallowing FY08 Project Director costs, SAMHSA relied on section 74.25(c)(7) of 45 C.F.R., which provides:

For nonconstruction awards, recipients shall obtain prior approvals from the HHS awarding agency for one or more of the following program or budget related reasons.

* * *

(7) Unless described in the application and funded in the approved award . . . transfer or contracting out of any work under an award.

SAMHSA asserted that SCSI "did not follow the DFC year one grant [FY08] budget when the Project Director position, approved under the category of a Personnel activity, was identified as a contractual activity on its reimbursement request."⁸ SAMSHA Att. J at 1. SCSI did not dispute that the FY08 DFC grant application identified the Project Director (Jon Quinton) as a personnel position with a salary of \$50,000 and a level of effort of 50% and that it hired the Project Director in FY08 as a consultant, without obtaining SAMHSA's prior approval for the change. *Id.* at 8 (unnumbered). SCSI's hiring the Project Director as a consultant in FY08 was, therefore, a violation of section 74.25(c)(7). The regulation contains no qualifier limiting its application based on a grantee's financial status.

SCSI argues that its action did not require prior approval because it was not (as yet) on "high risk status" and the "reallocation of funds did not exceed 25% of the total grant

⁸ SCSI alleges, and SAMHSA does not dispute, that after FY08 SAMHSA approved the Project Director position under contractual services rather than personnel. SCSI Br. at 12. The cost principles provide:

Prior approval means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

2 C.F.R. § 230.25(b). Thus, even if SCSI had prior approval from SAMHSA to hire a Project Director as a consultant in FY09, such prior approval for FY09 does not affect SAMHSA's disallowance of FY09 funds on the basis of conflict of interest. SAMHSA Response Br. at 6.

award amount." SCSI Br. at 6. SCSI did not cite any authority, even when asked to do so, for its position that these factors made section 74.25(c)(7) inapplicable here, nor do we know of any such authority. Tr. at 35.

SCSI argues that SAMHSA approved the shift of the Project Director position from employee to consultant in the FY09 and FY10 grant budgets and that the shift "is evidence of the immateriality of 45 C.F.R. Section 74.25(c)(7) to its Final Decision." SCSI Reply Br. at 4; *see also* SCSI Br. at 6.

SCSI did not submit any documentary support for its allegation. However, even assuming that SAMHSA knowingly approved the shift in later years, SAMHSA could reasonably rely on SCSI's failure to comply with section 74.25(c)(7) as an additional ground for the disallowance for FY08. The cost principles set forth specific standards for documenting employee costs (as opposed to consultant costs). For grantee employees, 2 C.F.R. § 230, Att. B ¶ 8.m.13 requires, among other things, "documented payrolls approved by a responsible official(s) of the organization[.]" Payment must also be based on "personnel activity reports" that (1) "reflect[] the distribution of activity of each [grant] employee"; (2) "reflect an after-the-fact determination of the actual activity of each employee"; (3) "account for the total activity for which employees are compensated"; (4) are "signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports." *Id.* These standards are particularly important where, as here, the employee does not spend 100% of his/her time on the grant. Therefore, requiring a part-time Project Director to be treated as an employee, particularly during the first year of a grant, significantly enhanced SAMHSA's ability to ensure that grant funds were properly charged and allocated to the grant, a benefit that cannot be accurately characterized as "immaterial."

Therefore, we conclude that SAMHSA properly disallowed funds paid to the Project Director for FY08 consultant services.

Conclusion

For the reasons discussed above, we uphold the disallowance in full.

/s/
Judith A. Ballard

/s/
Sheila Ann Hegy

/s/
Stephen M. Godek
Presiding Board Member