Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

New Hanover County Community Action, Inc.,
Docket No. A-12-81
Decision No. 2478
September 27, 2012

DECISION

New Hanover County Community Action, Inc. (New Hanover) appeals the May 2012 decision of the Administration for Children and Families (ACF) to terminate New Hanover's Head Start grant. ACF took that action after finding that New Hanover failed to timely correct three "deficiencies" in the operation of its Head Start program, each consisting of a failure to timely correct "noncompliance" with an applicable legal requirement ACF had previously identified.

ACF moved for summary disposition, arguing that New Hanover failed to raise any genuine dispute of material fact relating to ACF's findings for two of the deficiencies. As we explain below, we conclude that New Hanover did not raise a genuine dispute of material fact regarding whether it timely corrected its deficiency related to its financial management system. Failure to timely correct even one deficiency is an adequate basis for terminating a Head Start grant. We therefore grant ACF's motion for summary disposition and affirm ACF's decision to terminate New Hanover's Head Start grant.

Legal Background

Head Start grantees must comply with regulations specific to the Head Start program, and with regulations that apply to all Department of Health and Human Services (HHS) grants to non-profit organizations at 45 C.F.R. Part 74. 45 C.F.R § 1301.10(a). Those regulations, in turn, incorporate the principles for determining allowable costs under awards to non-profit grantees at 2 C.F.R. Part 230 (Office of Management and Budget Circular A-122). 45 C.F.R § 74.27(a).

The Secretary of HHS must review each Head Start grantee's program to determine whether it meets the program performance standards, which include administrative and financial management standards, at least once every three years. 42 U.S.C. § 9836a(c)(1). If a review finds that a grantee has a "deficiency," the Head Start Act requires the Secretary to "initiate proceedings to terminate the designation of the agency

unless the agency corrects the deficiency." 42 U.S.C. § 9836a(e)(1)(C). As relevant here, a "deficiency" includes "an unresolved area of noncompliance," which in turn "means failure to correct a noncompliance item within 120 days, or within such additional time (if any) as is authorized by the Secretary" after the grantee receives notice of the noncompliance. 42 U.S.C. § 9832(2)(C), (26).

The Secretary may require a grantee to correct a deficiency by the time specified in a Quality Improvement Plan (QIP) that the grantee must submit for the Secretary's approval, but in any event not later than one year after the grantee received notice of the deficiency.[1] 42 U.S.C. § 9836a(e)(1)(B)(iii), (e)(2)(A); s*ee also* 45 C.F.R. §§ 1304.60(f) ("the responsible HHS official will issue a letter of termination or denial of refunding" if a Head Start grantee "fails to correct a deficiency, either immediately, or within the timeframe specified in the approved [QIP]"); 1304.60(c) (QIP timeframes for correcting a deficiency may not exceed one year from the date that the grantee received official notification of the deficiencies to be corrected). A single uncorrected deficiency is sufficient to warrant termination of funding. 45 C.F.R. § 1303.14(b)(4) (authorizing termination for failure to correct "one or more deficiencies"); *see, e.g.*, *The Human Development Corporation of Metropolitan St. Louis*, DAB No. 1703, at 2 (1999).

Head Start grantees are entitled to an evidentiary hearing before the Board to contest the basis for ACF's termination decision. *See* 45 C.F.R. § 1303.16. In this case, ACF has asked the Board to grant summary disposition in its favor without a hearing. The Board has held that, under appropriate circumstances, it may grant summary disposition in the nature of summary judgment in a Head Start termination case without holding an evidentiary hearing "when there is no genuine dispute as to any material fact, and the moving party is entitled to judgment as a matter of law." *Camden County Council on Economic Opportunity*, DAB No. 2116, at 3-4 (2007), *aff'd*, 586 F.3d 992 (D.C. Cir. 2009); *Union Township Community Action Organization*, DAB No. 1976, at 6 (2005). The party moving for summary judgment bears the initial burden of showing the basis for its motion and identifying the portions of the record that it believes demonstrate the absence of a genuine factual dispute. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). If a moving party carries its initial burden, the non-moving party must "come forward with 'specific facts showing that there is a genuine issue for trial."' *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, 587 (1986) (quoting Fed. R. Civ. P. 56(e)).

[1] Alternately, the Secretary may require the grantee to correct a deficiency immediately, if it threatens the health or safety of staff or program participants or poses a threat to the integrity of federal funds, or within 90 days if the Secretary finds a 90-day period reasonable, in light of the nature and magnitude of the deficiency. 42 U.S.C. § 9836a(e)(1)(B)(i), (ii).

To defeat an adequately supported summary judgment motion, the non-moving party may not rely on general denials in its pleadings or briefs, but must furnish evidence of a genuine dispute concerning a material fact--a fact that, if proven, would affect the outcome of the case under governing law. *Id.* at 586, n.11; *Celotex*, 477 U.S. at 322-24. In deciding a summary judgment motion, a tribunal must view the entire record in the light most favorable to the non-moving party, drawing all reasonable inferences from the evidence in that party's favor. *Camden County Council on Economic Opportunity* at 4.

The burdens of proof applicable to Head Start grant terminations are well-settled: ACF must make a prima facie showing (that is, proffer evidence sufficient to support a decision in its favor absent contrary evidence) that it has a basis for termination under the relevant regulatory standards. *Friendly Fuld Neighborhood Center, Inc*., DAB No. 2121, at 3 (2007); *First State Community Action Agency, Inc.*, DAB No. 1877, at 9 (2003); *Rural Day Care Association of Northeastern North Carolina*, DAB No. 1489, at 7-8 (1994), *aff'd*, No. 2:94-CV-40-BO (E.D.N.C. Dec. 19, 1995). If ACF makes this prima facie showing, the grantee must demonstrate by a preponderance of the evidence that it is in compliance with program standards. *Id.*

In Head Start termination appeals, a grantee bears the burden to demonstrate that it has operated its federally-funded program in compliance with the terms and conditions of its grant and the applicable regulations. *Norwalk Economic Opportunity Now, Inc.*, DAB No. 2002, at 7 (2005). A grantee, moreover, is clearly in a better position to establish that it did comply with applicable requirements than ACF is to establish that it did not. Therefore, the Board has held that the ultimate burden of persuasion is on the grantee to show that it complied with program standards. *Friendly Fuld Neighborhood Center, Inc.* at 3-4.

Case Background

ACF conducted an on-site triennial monitoring review of New Hanover's Head Start program on December 13–18, 2009 (December 2009 review) and follow-up reviews on February 3–4 and 22–25, 2011 (February 2011 review), and February 13-17, 2012 (February 2012 review). Among the noncompliance findings from the December 2009 review were findings that New Hanover's financial management systems failed to provide accurate disclosure of the financial results of its Head Start program as required by 45 C.F.R. § 74.21(b)(1), that New Hanover failed to conduct a "community assessment" that met the requirements of the Head Start regulations at 45 C.F.R. § 1305.3, and that New Hanover did not ensure that 10 percent of enrolled children were

children with disabilities as required by section 640(d) of the Head Start Act (42 U.S.C. § 9835(d)) and 45 C.F.R. § 1305.6(c). ACF Ex. 1 (December 2009 review report). ACF notified New Hanover of the December 2009 review findings on April 29, 2010 and told New Hanover that under federal law, any area of noncompliance that was not corrected within 120 days would become a deficiency that New Hanover would have to correct "within the time period required by the responsible HHS official." *Id*. at 11.

As a result of the February 2011 review, ACF determined that New Hanover had failed to correct its noncompliance with the three requirements identified above. ACF Ex. 2 (February 2011 review report). ACF notified New Hanover of the February 2011 findings on August 12, 2011 and told New Hanover that the uncorrected areas of compliance had become deficiencies under federal law and that New Hanover had 30 days to submit for ACF's approval a QIP detailing its plan to correct the deficiencies. *Id*. at 1, 14. ACF further informed New Hanover that the areas of deficiency "must be fully corrected within six months from the date you receive this report or within such additional time not to exceed one year as authorized by the responsible HHS official" under section 641A(e)(1)(B)(iii) of the Head Start Act, 42 U.S.C. § 9836a(e)(1)(B)(iii). *Id*. at 13. New Hanover submitted a QIP on September 13, 2011, which ACF approved on October 25, 2011. ACF Exs. 3, 28.

As a result of the February 2012 review, ACF determined that New Hanover had failed to correct any of the three deficiencies, requiring the initiation of termination proceedings under 42 U.S.C. § 9836a(e)(1)(C) and 45 C.F.R § 1303.14(b)(4).[2] ACF Ex. 6, at 1. With the report of the review, dated May 16, 2012, ACF enclosed a notice of termination. ACF Ex. 7. New Hanover filed a timely appeal with the Board.

In its appeal submission, New Hanover did not specifically dispute ACF's findings but raised concerns about how much time New Hanover was given to correct the deficiencies and about ACF's refusal to reschedule the February 2012 review following the resignation of New Hanover's finance officer. ACF responded that the termination should be sustained based on the three deficiencies, and also moved for summary disposition in its favor based on the financial management and the community assessment deficiencies. ACF Response and Motion for Summary Disposition (MSD) at 4.

[2] ACF also determined based on the February 2012 review that New Hanover had four new "areas of noncompliance" and that four other areas of noncompliance identified in previous reviews were uncorrected and had become deficiencies. ACF Ex. 6, at 13-25. Those four deficiencies are not the basis of the termination action or ACF's motion for summary disposition.

New Hanover's reply to ACF's response and motion did not specifically state whether New Hanover disputed any factual findings related to the two deficiency findings ACF said were undisputed, nor explain how any of the facts New Hanover asserts are material to the Board's decisionmaking, but did request additional time to submit affidavits from its proposed witnesses. The Board thus ordered New Hanover to respond specifically to ACF's motion for summary disposition, informing New Hanover that, to defeat the motion, it had to show that the evidence in the case raises a genuine dispute of fact material to whether ACF has a valid basis for terminating the grant. The order also provided New Hanover an opportunity to submit any affidavits responsive to ACF's motion. New Hanover then submitted its Supplemental Response to ACF's Motion for Summary Disposition (Supp. Resp.) with exhibits, one affidavit, and one declaration. ACF submitted a reply brief.

Analysis

We conclude that New Hanover raised no genuine dispute of fact material to ACF's conclusion that New Hanover failed to correct the noncompliance with 45 C.F.R. § 74.21(b)(1), which became a deficiency that New Hanover also failed to timely correct, requiring ACF to terminate New Hanover's Head Start funding.

Section 74.21, titled "Standards for financial management systems," states: "Recipients' financial management systems shall provide for the following: (1) Accurate, current and complete disclosure of the financial results of each HHS-sponsored project or program in accordance with the reporting requirements set forth in § 74.52." Section 74.52, titled "Financial reporting," requires non-profit grantees such as New Hanover to file specified financial reporting forms. The Board has held that "[b]eing able to account for the expenditure of federal funds" by, among other things, "documenting that an expenditure of grant funds is allowable" is "a central responsibility of any grantee," and the failure to do so was among the grounds supporting a determination that the grantee did not have a financial management system that provided for "[a]ccurate, current, and complete disclosure of financial results . . . in accordance with" applicable reporting requirements as required by 45 C.F.R. § 74.21(b)(1). *Recovery Resource Center, Inc.*, DAB 2063 at 12-13 (2007). In *Recovery Resource Center, Inc.*, the Board observed that "[c]ontributing to the portrait of financial mismanagement" supporting the denial of continued grant funding for reasons including failure to comply with section 74.21(b)(1) "was [grantee's] use of federal funds to cover 'unallowable' costs — that is, costs that are not necessary and reasonable for performance of the federally-supported project." *Id.*; *see also id.* at 16 (audit findings including charging unallowable costs to grant funds corroborated findings that grantee "lacked an adequate system of financial management"). Similarly, in *Campesinos Unidos, Inc.*, DAB No. 1518, at 28-31 (1995),

ACF's finding that the grantee "failed to comply with the requirement that costs be necessary and of benefit to the Migrant Head Start program" and "failed to compare budgeted costs to actual costs in a timely manner" were among "serious" problems supporting ACF's determination that grantee "did not have a financial management system in place that ensures timely, accurate, current, and complete disclosure of financial matters."

Here, as discussed below, undisputed facts establish that over a three-year period New Hanover did not have the requisite financial management systems but instead was unable to accurately report, and consistently overstated, the costs of its Head Start program. Absent the required financial management systems, there was "no assurance that the full amount of funds awarded for direct services" to Head Start children and their families "were actually being expended for that purpose." *Campesinos Unidos, Inc.,* at 31; *see also Southern Delaware Center for Children and Families*, DAB No. 2073, at 21 (2007) ("lack of reliable financial information provides ACF little assurance that the children the Head Start program is funded to serve will receive the appropriate Head Start services").

> <u>New Hanover does not specifically dispute ACF's findings that it was not in compliance with section 74.21(b) as of the December 2009 review and that the noncompliance had not been corrected as of the February 2011 review.</u>

The December 2009 review found that New Hanover failed to ensure that its financial management systems provided accurate disclosure of the financial results of its Head Start program because New Hanover overstated its indirect costs for the year ending May 31, 2009 on its final Financial Status Report form (SF-269) for that year by $4,668. ACF Ex. 1, at 5. The applicable cost principles distinguish direct costs that can be readily identified with a specific cost objective and indirect costs that cannot be so identified. 2 C.F.R. Part 230, App. A, ¶¶ C-E. To charge indirect costs, a grantee may use an indirect cost rate that is negotiated with, and must be approved by, the cognizant federal agency. The rate is determined as a ratio of indirect to direct costs, expressed as a percentage and must be applied to the distribution base used to calculate the rate, such as salaries and wages. *Id.*

ACF found that New Hanover erroneously based its claim for indirect costs on budgeted salaries and wages of $1,018,473 rather than its actual salaries and wages of $994,536.26. ACF Ex. 1, at 5. New Hanover's Finance Officer acknowledged the error in an interview during the review, and New Hanover does not specifically dispute this finding on appeal. *Id.* Based on this finding, ACF determined that New Hanover had an area of noncompliance that would become a deficiency if it was not corrected within 120 days. *Id.* at 11.

The February 2011 review found that New Hanover again failed to ensure that its financial management systems provided accurate disclosure of the financial results of the Head Start program, this time because New Hanover failed to accurately report the federal and non-federal shares of its Head Start funding. ACF Ex. 2, at 9-10. In general, each Head Start grantee must furnish 20 percent of the total costs of its Head Start program. 42 U.S.C. § 9835(b); 45 C.F.R. § 1301.20(a).[3] This "non-federal share" may consist of cash or in kind contributions, "fairly evaluated, including plant, equipment, or services." 42 U.S.C. § 9835(b).

The February 2011 review found that New Hanover reported on its SF-269 dated December 29, 2010 that, for the 6-month period ending November 30, 2010, its federal and non-federal shares were $773,979 and $267,660, respectively, whereas its underlying documentation, a Revenue and Expenditure report, disclosed federal and non-federal shares of $793,553 and $269,977, respectively. ACF Ex. 2, at 9-10. The report of the review states that New Hanover's bookkeeper could not explain the reason for the differences noted, and that New Hanover did not maintain schedules to permit reconciliation of the amounts reported on the SF-269. *Id*. New Hanover does not specifically dispute these findings. The Board has explained the vital role of the financial report and the requirement that the grantee accurately report its true financial condition, stating that the SF-269 form is "a financial report that a grantee has the obligation to complete accurately and is, along with required annual audits, one of two 'key elements to ACF's ongoing oversight of Head Start grantees' fiscal management.'" *Southern Delaware Center for Children and Families* at 21.

The February 2011 review also found that New Hanover erroneously reported its non-federal share of funding for the year ending May 31, 2010 because of problems in New Hanover's claims for the in-kind value of donated space.[4] Specifically, the review found that New Hanover claimed an in-kind contribution for use of 100 percent of the "Peabody Center," which housed New Hanover's administrative offices and also space for its other programs, even though New Hanover's Executive Director stated that she believed that

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[3] Federal financial assistance granted for a Head Start program "shall not exceed 80 percent" of the total approved costs of the program, unless the Secretary of HHS approves a higher percentage applying criteria specified in the statute. *Id.* Even if New Hanover needed to provide less than 20 percent as its non-federal share, however, it was subject to the requirements for accounting for that non-federal share.

[4] The report of the February 2011 review states that both New Hanover's final SF-269 and its Consolidated Revenue and Expenditure report for the year ending May 31, 2010 showed a non-federal share of $535,320, and that the Consolidated Revenue and Expenditure report reflected $425,196 as the in-kind value of donated space. ACF Ex. 2, at 10.

only 85 percent of the building was used by Head Start. ACF Ex. 2, at 10; *see* ACF Exs. 22-25 (New Hanover journal transactions indicating that one third of the Peabody building was used for non-Head Start purposes). The review also found that New Hanover twice claimed the value of playground space that was used by two of its centers, Castle Haynes (1,800 square feet at $2.50 per square foot) and Rock Hill (7,151 square feet at $0.63 per square foot). ACF accordingly concluded that New Hanover's SF-269 reports could not be reconciled to its financial records, and that its supporting schedules for non-federal share reported on the SF-269 were inaccurate. ACF Ex. 2, at 10. New Hanover does not specifically dispute these findings.

As noted above, ACF notified New Hanover on August 12, 2011 that its uncorrected noncompliance with section 74.21(b)(1) had become a deficiency, that New Hanover had 30 days to submit a QIP, and that any deficiencies "must be fully corrected within six months from the date you receive this report or within such additional time not to exceed one year as authorized by the responsible HHS official" or funding would be terminated. ACF Ex. 2, at 13-14.

The QIP New Hanover submitted on September 13, 2011, and which ACF approved, stated that New Hanover would complete all steps it proposed to correct the financial management systems deficiency by November 15, 2011. ACF Exs. 3, 28. In an update to the QIP that ACF received on January 10, 2012, New Hanover reported that it had not completed all of the steps described in the QIP to correct the deficiency. ACF Ex. 4. In a second update received on January 27, 2012, New Hanover reported that it would complete the QIP corrective measures for the financial management systems deficiency no later than February 3, 2012. ACF Ex. 5. There is no evidence that ACF treated any of these "updates" as revisions to the QIP or otherwise approved any revision to the QIP to extend the time to correct the deficiency. In any event, as we discuss next, the undisputed facts show that New Hanover had failed to correct the deficiency, even as late as February 3, 2012.

<u>Undisputed facts demonstrate that New Hanover failed to correct the financial management systems deficiency by the time required by its QIP.</u>

The February 2012 review determined that New Hanover had not corrected the deficiency and remained out of compliance with section 74.21(b)(1) because the final federal Financial Report form (SF-425) for the period ending May 31, 2011, which New Hanover submitted on February 3, 2012, "contained overstated claims for indirect costs and non-Federal share."[5] ACF Ex. 6, at 3-4. The February 2012 review found that New Hanover had overstated its indirect costs by using a direct cost base that exceeded its

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[5] The SF-425 replaced the SF-269. *See* 73 Fed. Reg. 47,246 (Aug. 13, 2008).

actual base ($1,097,319 vs. $1,082,212 in direct salaries and wages), and also by using indirect cost rates in excess of its approved indirect cost rate for that program year. *Id.* The February 2012 review further found that New Hanover had overstated the in-kind value of property used for the Head Start program. *Id.* As we discuss below, New Hanover proffered no evidence that, even viewed in the light most favorable to New Hanover, demonstrates the existence of a genuine dispute of material fact. Nor do New Hanover's arguments show any legal error in ACF's determination that New Hanover failed to correct the deficiency.

New Hanover overstated its indirect costs for the year ending May 31, 2011.

New Hanover does not specifically dispute ACF's finding that, for the year ending May 31, 2011, New Hanover reported indirect costs calculated using a direct cost base that exceeded the actual, correct base. Nor does New Hanover specifically dispute the findings that it calculated the reported indirect costs using rates of 17.1 percent for June 2010 and 19.5 percent for July 2010 through March 2011, even though its approved provisional indirect cost rate was only 16.3 percent. ACF Exs. 15 (Nonprofit Rate Agreement, Aug. 26, 2011), 16 (SF-425 for year ending May 31, 2011, stating that New Hanover calculated indirect costs "using 3 different rates during the period.").[6] ACF submitted a declaration from Jim Sattler, a financial reviewer who participated in the February 2012 review with an ACF contractor. ACF Ex. 31. He stated that New Hanover's Executive Director confirmed during the February 2012 review that the only approved indirect cost rate during the budget period was 16.3 percent. *Id.* at ¶ 9.

While not disputing ACF's findings as to the rates it used, New Hanover states that the 16.3 percent provisional rate "was final only through the budget period ending on May 31, 2010" and that the "next approved rate from the Division of Cost Allocation was received on March 29, 2012 with an amended rate for the budget period ending May 31, 2011." New Hanover Supp. Resp. at 4. The exhibit it cites, a Nonprofit Rate Agreement with the HHS Division of Cost Allocation dated February 28, 2012, which New Hanover received on March 29, 2012 and signed on April 5, 2012, establishes a final indirect cost rate of 13.80 percent for the period June 1, 2010 through May 31, 2011. New Hanover Ex. 1. On its face, this rate agreement plainly was not in effect on February 3, 2012, when New Hanover submitted its Final SF-425 for that period, so it is irrelevant to the accuracy of that financial report.

[6] The amounts New Hanover listed on the SF-425 as total indirect costs ($207,501) and indirect cost base ($1,097,379) indicate an effective overall indirect cost rate of 18.9 percent. ACF Ex. 16.

New Hanover's provisional 16.3 percent indirect cost rate was in effect "until amended." ACF Ex. 15 (Nonprofit Rate Agreement). The agreement was not amended until at least February 28, 2012, the date of the subsequent agreement, and the 16.3 percent indirect cost rate is, in fact, the rate New Hanover identified on the SF-425 as the applicable rate. New Hanover Ex. 1; ACF Ex. 16 (final SF-425 for the year ending May 31, 2011, dated February 3, 2012). The applicable cost principles in federal regulations required New Hanover to use this approved rate in claiming indirect costs. *See*, *e.g.*, 2 C.F.R. Part 230, App. A, ¶¶ D.2.a, D.2.d (the negotiated indirect cost rate approved by the cognizant federal agency "is used to distribute indirect costs to individual awards" and "is applicable to all awards at the [grantee] organization"); ¶ E.1.e (provisional indirect cost rate applicable to a specified period "is used for . . . reporting indirect costs on awards pending the establishment of a final rate for the period"); *see also North Central West Virginia Community Action Association, Inc.*, DAB No. 1604 (1996) (sustaining disallowance where grantee claimed "more indirect costs than it was entitled to under its approved provisional rate" for the time period at issue). In any event, even if the 13.80 percent rate were the proper rate to use to calculate the indirect costs (which it was not), we would still conclude that the financial report dated February 3, 2012 was inaccurate since New Hanover does not deny it in fact used the 17.1 and 19.5 percent rates and used an incorrect direct cost base to calculate the indirect costs it reported. Indeed, if the 13.80 percent rate applied, that would mean that New Hanover had overstated its indirect costs by an even greater amount than what ACF found.

Thus, the undisputed facts establish that New Hanover inaccurately reported its indirect costs by using rates in excess of its approved rate for the time period at issue and by using a direct cost base that exceeded the actual base.

New Hanover overclaimed the in-kind value of real property claimed towards its non-federal share of Head Start funding.

The uniform administrative requirements at 45 C.F.R. Part 74 require that "cost sharing or matching contributions, including cash and third party in-kind, shall meet" the specified criteria, including that they be "verifiable from the recipient's records," "allowable under the applicable cost principles" and "not paid by the Federal Government under another award, except where authorized by Federal statute to be used for cost sharing or matching." 45 C.F.R. § 74.23(a)(1), (4), (5). For a cost to be "allowable," the cost principles require that it be "reasonable for the performance of the award and be allocable thereto" and be "adequately documented," and the total costs must be "less any applicable credits." 2 C.F.R. Part 230, App. A, ¶¶ A.1, A.2. Moreover, the "value of donated land and buildings shall not exceed its fair market value at the time of donation to the recipient as established by an independent appraiser" and the "basis for determining the valuation for . . . buildings and land shall be documented" in a grantee's "supporting records for in-kind contributions from third parties." 45 C.F.R. § 74.23(h), (i).

The February 2012 review found that New Hanover's claim for the in-kind value of real property on its financial report for the year ending May 31, 2011, submitted on February 3, 2012, "exceeded the amount reflected in an independent appraisal, misapplied the fair-rental values reflected in the appraisal, and was improperly based on the fair-rental value of space owned by the grantee and a related party under the grantee's control, resulting in overstated claims for non-Federal share." ACF Ex. 6, at 3-4. First, ACF determined that New Hanover recorded the value of donated space in the "CDC building" as $2,150, even though an independent appraiser's report prepared for New Hanover valued the space at $1,075 per month as of April 29, 2011. *Id*. at 4; ACF Ex. 21, at 2, 6 (Appraiser's Report showing annual fair-rental value of $12,000). The February 2012 review also found that New Hanover owned the CDC building and that its claim for the in-kind value of the building was therefore limited to depreciation of $694 per month, based on its acquisition cost of $250,000 over a 30-year useful life. ACF Ex. 6, at 4, 17. New Hanover does not specifically dispute these findings or ACF's legal basis for the findings. The applicable cost principles require that a grantee's charges for the use of real property it owns "be made through use allowance or depreciation." 2 C.F.R. Part 230, App. B, ¶ 11.a. New Hanover violated that requirement by claiming an in-kind contribution for the rental value of the CDC building in attempting to satisfy its non-federal share requirement.

ACF also determined in the February 2012 review that New Hanover's claim for the in-kind value of the "Peabody Center" was excessive because (1) New Hanover made separate claims for Peabody Center facilities that were included in the appraised value of the building, such as the parking lot, playground, and auditorium; (2) the Peabody Center had been previously renovated with federal Head Start funds; and (3) the owner of the property was Friends of New Hanover County Community Action, Inc. (Friends, Inc.), a "related party" under the control of New Hanover. ACF Ex. 6, at 4, 17. The record shows, and New Hanover does not dispute, that Friends, Inc. received the Peabody Center from the New Hanover County Board of Education as a donation in 1988 and leased it to New Hanover for an annual rent of one dollar. *Id*.; ACF Ex. 31, at ¶ 20 (Sattler decl.); New Hanover Ex. 7 (lease agreement between New Hanover and Friends, Inc. for Peabody property at annual rent of $1.00). We address each of ACF's findings below, and explain why we conclude New Hanover has not shown the existence of a genuine dispute of fact material to the issue of whether it inaccurately reported the in-kind value of the Peabody Center.

ACF found that New Hanover claimed an in-kind contribution of $29,523 per month for the use of the Peabody Center building, playground, auditorium, and parking lot, although the independent appraiser's report assessed the annual fair-rental value of the Peabody Center at $259,500, or $21,625 per month. ACF Exs. 6, at 4, 16, 17; 21, at 2.

New Hanover's journal transactions show, and New Hanover does not deny, that it claimed a separate in-kind rental value for the Peabody Center playground, auditorium, and parking lot, in addition to the rental value it claimed for the Peabody Center building. ACF Exs. 22-25; ACF Ex. 6, at 17. The financial reviewer, Mr. Sattler, stated that New Hanover "inflated the value of the properties in its non-federal share by adding value for the playgrounds and the parking lot" at the Peabody Center, which, he stated, "is not a correct method for valuing property" and "contributed to the inaccurate disclosure of New Hanover's non-federal share." ACF Ex. 31, at ¶ 22.

New Hanover argues that the appraised value of the Peabody Center did not include its parking lot and playground. New Hanover Supp. Resp. at 4-5. New Hanover points out that the appraiser's report states that the annual rental value for the Peabody School was $259,500 for "gross building area." *Id.*, citing New Hanover Ex. 2; *see also* ACF Ex. 21, at 2. New Hanover states that its Fiscal Officer at the time, based on attendance at ACF Head Start fiscal training in 2011, believed that "the pertinent parking lots and playground areas . . . were not viewed in her opinion as 'gross building area' but instead outdoor space made available to the grantee for use by the Head Start program." New Hanover Supp. Resp. at 4-5. New Hanover discounts the financial reviewer's statement as to the propriety of separately claiming the playgrounds and the parking lot as a personal opinion unsupported by legal citation. *Id.* at 5.

In making this argument, New Hanover misapprehends its burden as a Head Start grantee, discussed above, of demonstrating that it operated its Head Start program in compliance with applicable legal requirements. Additionally, and more generally, it is well-established that once a federal agency has questioned the allowability of a grantee's particular expenditures, as ACF has done here, the burden falls on the grantee to demonstrate that the expenditures were allowable. *Recovery Resource Center, Inc.* at 16, citing 45 C.F.R. § 74.21(b)(7) (requiring a financial management system that maintains accounting records supported by source documentation), 2 C.F.R. Part 230, App. A, ¶ A.2.g (allowable costs must be "adequately documented"), and *Northstar Youth Services*, DAB No. 1884, at 5 (2003) ("Once a cost is questioned as lacking documentation, the grantee bears the burden to document, with records supported by source documentation, that the costs were actually incurred and represent allowable costs, allocable to the grant").

New Hanover has not proffered evidence that, viewed in the light most favorable to it, would establish that it accurately reported the value of the Peabody Center. First, New Hanover did not proffer any declaration or other evidence supporting its assertion that its then Fiscal Officer believed that the appraised value of the Peabody Center did not include the value of the playground and parking lot, nor any evidence to rebut the

financial reviewer's statement that assigning a separate value would not be a correct appraisal method for valuing property. Second, while the appraiser's report refers to square footage of "the building area," the report as a whole cannot reasonably be read to limit the appraised value to only the value of building. The appraiser's report also refers to the Peabody School "property," describes the "[r]ecent renovations" to the property as including not only reroofing of the main facility, but also including new fencing, new street lighting, and new playground equipment, and includes photographs of the playground and parking areas, indicating that the assessed value of the property included those facilities. ACF Ex. 21, at 4; New Hanover Ex. 2. Additionally, New Hanover proffered no evidence that the square footage of the "gross building area" did not include the square footage of the auditorium, and the appraiser's report refers to "roof patching over the auditorium/cafeteria" as a recent renovation. ACF Ex. 21, at 4. Indeed, New Hanover does not even aver that its Fiscal Officer did not view the auditorium as part of the building.

Even if New Hanover had proffered evidence that the Peabody Center appraisal did not include the playground or parking, moreover, that evidence would not be sufficient to establish that New Hanover accurately claimed and reported the rental value of those facilities. The record shows that New Hanover claimed them at the same per-square-foot rental cost ($7.43) that that the appraiser assigned to the Peabody Center. ACF Exs. 22-25. If, as New Hanover suggests, the independent appraiser evaluated only the building, New Hanover could not rely on his appraisal as establishing the fair market value of the playground and parking lot as well as the building. As stated above, the regulations require that fair market rental value be established by an independent appraiser. 45 C.F.R. § 74.23(h). New Hanover does not claim to have any basis for assigning to the playground and parking lot the per-square-foot value from the appraiser's report it says pertains only to the building. Moreover, New Hanover could not reasonably believe that the fair market value of the playground and parking lot considered separately would be the same as the value of the building, especially in the absence of any independent appraisal of the playground and parking lot as separate facilities.

New Hanover also does not specifically dispute that, as the financial reviewer stated in his declaration, "New Hanover had to do extensive renovations on the [Peabody] property, using Head Start funds in part, before the building could be occupied and used for Head Start purposes." ACF Ex. 31 at ¶ 20; *see also* ACF Ex. 6, at 4, 17 (citing newspaper article showing "$32,000 in renovations" to the Peabody building "paid by [ACF]"). New Hanover does not address how it could properly claim the full fair-market rental value of the Peabody Center as its non-federal share required to support its claim for federal Head Start funds, when federal funds already paid for a part of the cost of

making the building suitable for use as a Head Start facility. *See* 45 C.F.R. § 74.2 ("Federal share of real property . . . means that percentage of the property's . . . acquisition costs and any improvement expenditures paid with Federal funds.")[7] New Hanover proffered no evidence to show that, in determining the amount to be charged for the in-kind value of the Peabody Center, it accounted for the use of federal funds to finance renovations required before the property was suitable for use as a Head Start facility.

ACF also asserts that claims for the Peabody Center should be limited to depreciation because Friends, Inc., the owner, was "a related party under New Hanover's control." ACF Exs. 31, at ¶ 19 (Sattler decl.); 6, at 4, 17-18; *see* 2 C.F.R. Part 230, App. B, ¶¶ 43.b, c (limiting allowable rental costs "under 'less-than-arms-length' leases" to "expenses such as depreciation or use allowance, maintenance, taxes, and insurance"). New Hanover disputes that determination and asserts that "there is no ability by either party, individually or collectively, to substantially or otherwise influence or control the actions of the other." New Hanover Supp. Resp. at 5. We do not need to resolve the issue of whether Friends, Inc., was under New Hanover's control because, as discussed above, the undisputed facts provide ample support for our conclusion that New Hanover failed to have financial management systems that provided for accurate disclosure of the value of the in-kind contributions New Hanover claimed.[8] Because New Hanover inaccurately reported the amount of its non-federal share, New Hanover also inaccurately reported the amount of federal funds to which it was entitled.

Because the existence of this uncorrected deficiency in financial management authorized ACF's termination action, none of the disputes regarding ACF's other deficiency findings are material to our decision.

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[7] The cost principles also state that "[i]n some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits" and explain that "the concept of netting such credit items against related expenditures should be applied . . . in determining . . . amounts to be charged to Federal awards for services rendered **whenever the facilities . . . used in providing such services have been financed directly, in whole or in part, by Federal funds**."). 2 C.F.R. Part 230, App. A, ¶ A.5.b (emphasis added).

[8] We note, however, that New Hanover's Executive Director, in her declaration, does not deny ACF's report that New Hanover's Board members stated that she controlled the Peabody building and made all decisions regarding its upkeep, repair, and renovation, or that she was Friend's registered agent, or the statement of the financial reviewer that the Board Chairperson of Friends had stated that the only purpose of Friends was to provide a building for New Hanover. ACF Exs. 6, at 17; 31 at ¶ 21.

<u>New Hanover's other arguments furnish no basis to reverse the termination.</u>

New Hanover disputes generally ACF's statement that New Hanover was not in compliance with three Head Start requirements "over a period of more than two years [and] represented it would correct these areas of noncompliance, which turned into deficiencies, but . . . failed to do so." ACF MSD at 15-16. New Hanover cites what it calls "the discrepancy between the ACF termination letter and the monitoring review report concerning the date of the initial deficiency[.]" New Hanover Supp. Resp. at 7. New Hanover refers to the fact that ACF's termination letter states that New Hanover was first notified of the deficiencies by letter dated August 12, 2011 (forwarding the report of the February 2011 review), whereas the report of the February 2012 review, which was sent to New Hanover with the termination letter on May 16, 2012, contains a table that gives December 13, 2009 as the "Date of Review in which [each] Deficiency was identified." ACF Exs. 7, at 1; 6, at 2. The reports of the three reviews, however, make clear that, as relevant here, the December 2009 review identified only areas of noncompliance that would become deficiencies if not corrected within 120 days of receipt of the report. ACF Exs. 1, 2, 6. In other words, the table in the February 2012 review report mistakenly indicated that "deficiencies" were identified in the December 2009 review, whereas the noncompliances identified in that review became deficiencies only when not corrected. New Hanover does not explain, in any event, how this mistake is relevant, and, we cannot see how it alone would provide a basis on which we could invalidate the termination action.

New Hanover also argues that it was not given a full year to correct the deficiencies as permitted in the regulations, and that ACF improperly denied its requests to reschedule the February 2012 monitoring visits following the unexpected resignation of its finance officer, which hindered its ability to complete its QIP measures. These arguments do not provide a basis for the Board to reverse the termination. While a grantee may be given up to one year to correct certain deficiencies pursuant to its approved QIP, the Head Start regulations also direct ACF to terminate Head Start funding if a grantee does not correct its deficiencies "immediately, or within the timeframe specified" in the approved QIP. 45 C.F.R. § 1304.60(f). Nothing in the law requires that grantees be given a full year to correct deficiencies pursuant to a QIP. Here, New Hanover did not correct its financial management deficiency by the November 15, 2011 timeframe specified in its original approved QIP or even by the February 3, 2012 date that New Hanover put in the second update to its QIP (but which ACF did not clearly approve). ACF Exs. 3, 5. ACF was thus authorized to terminate its funding. The Head Start regulations authorize the Board to review the "denial of refunding, termination of financial assistance, and suspension of financial assistance." 45 C.F.R. § 1303.1. Even if ACF had denied explicitly approval of a QIP proposing a full year to correct the deficiency, nothing in the Head Start regulations permits the Board to review the disapproval of a QIP or a decision not to extend the time for correcting deficiencies to which a grantee committed itself in its QIP.

Conclusion

For the reasons explained above, we grant ACF's motion for summary disposition and affirm ACF's decision to terminate funding for New Hanover's Head Start grant.

/s/
Stephen M. Godek

/s/
Sheila Ann Hegy

/s/
Judith A. Ballard
Presiding Board Member