

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Kent Community Mental Health
Center Services Board
Grand Rapids, Michigan
Docket No. 78-110
Decision No. 138

DATE: December 1, 1980

DECISION

The Kent Community Mental Health Center Services Board (grantee) appealed a decision of the Alcohol, Drug Abuse, and Mental Health Administration (ADAMHA) Informal Grant Appeals Committee, disallowing \$64,943 in costs claimed for grantee's Community Mental Health Center staffing project. The issue in this case arises from grantee's use in a subsequent budget period of funds awarded for use in an earlier budget period but remaining unobligated at the end of that period (sometimes called "carryover" funds). The ADAMHA Committee viewed the case as involving the question of whether the applicable policy statements prohibited use of carryover funds in a subsequent budget period without authorization. While we agree that such authorization was required, we view the matter differently. For the reasons discussed below, we have determined that, unless the agency can show that there were substantial programmatic reasons for denying retro-active authorization for grantee's use of the funds, the disallowance should be reversed.

The record for this decision consists of grantee's application for review and supplementary submissions and a response to the appeal submitted by the Public Health Service (PHS), which relied primarily on the record before the ADAMHA Committee. PHS is the constituent agency for purposes of Board review of the ADAMHA disallowance.

Background

Grantee's project was approved for an eight year project period from July 1, 1969, through June 30, 1977. The following chart compares, for each budget period ending on June 30 of the indicated year, the total approved federal budget, the amount of the continuation grant award, and the amount expended:

Budget Period	Year	Approved Budget	Amount of Award	Amount Expended	Under (Over) Budget
01	1970	\$168,576	\$168,576	\$121,176	\$47,400
02	1971	250,122	213,022	205,586	44,536
03	1972	212,752	202,752	190,357	22,395
04	1973	160,650	160,650	160,650	- 0 -
05	1974	112,455	112,455	124,636	(12,181)
06	1975	118,078	118,078	126,158	(8,080)
07	1976	123,981	123,981	149,772	(25,791)
08	1977	123,981	123,981	142,872	(18,891)
<hr/>					
Total			\$1,223,495	\$1,221,207	(\$64,943)

As the chart indicates, grantee underexpended in the early years of the project. Of \$47,400 in unobligated funds from the 01 budget period, \$37,100 was identified as an unobligated balance on the 02 grant award notice and the amount of the award calculated as the difference between that amount and the total approved federal budget (\$250,122 - \$37,100 = \$213,022). The 03 notice identifies \$10,000 as an estimated unobligated balance from prior budget periods and adjusts the 03 award similarly (\$211,752 budget - \$10,000 carryover = \$202,752 award). The grant award notices for subsequent budget periods are left blank in the space for unobligated balances, and the amount of the award always equals the total approved federal budget.

A Notice of Disposition of Grant Unexpended Balance, dated April 30, 1974 (almost 4 years after the end of the 01 budget period), stated that \$47,400 was transferred to the 02 budget period. A similar notice dated May 15, 1974, transferred \$54,836 to the 03 period. These notices contain the following language:

When the amount transferred, together with the amount of the award for the continuation grant period, results in overfunding, THE EXCESS IS NOT AVAILABLE FOR EXPENDITURES during the current budget period and will either be withdrawn by means of a revised award or used to support a future budget.

Although \$47,100 of the excess from the 01 period was, in effect, "withdrawn" by the 02 and 03 notices, excess in subsequent periods was never reflected in any award notice revisions.

Grantee began in the 05 budget period to incur costs in excess of the amount of the approved budget for the period and to charge the costs to federal carry-over funds. This was shown on grantee's report of expenditures submitted to the agency shortly after the end of the budget period. The agency took no

action. In the 06 and 07 budget periods, grantee similarly charged costs to carryover funds and then reported it in a timely manner.

As a result of a site inspection by the agency in early 1977, grantee became concerned about the lack of written approval to spend the carryover funds. By letter of February 9, 1977, grantee requested that use of the carryover funds be authorized and recommended a method by which this might be accomplished. No action was taken on this request prior to the end of the project period.

Subsequently, the HEW Audit Agency audited costs claimed by grantee for the entire project period. The auditors' findings, transmitted to the grantee in final on November 14, 1977, were that grantee had properly accounted for federal funds, in general, but had "claimed \$64,943 in costs in excess of the approved grant budget awards...." Audit Report, ACN 81489-05, p. 2.

By letter of May 22, 1978, the Financial Advisory Services Officer, ADAMHA, informed grantee that ADAMHA was disallowing \$64,943 based on the auditors' finding that this amount represented excess costs. The disallowance letter stated: "The Regional Office concurs with the auditor's finding and has informed us that they have since sent a letter to the Board disapproving its request for retroactive approval of the amount claimed in excess of the approved budgets." p. 2. An April 18, 1978 memorandum from the Director, Office of Grants Management, Region V, to the Regional Health Administrator refers to a meeting at which grantee's request was discussed. This memorandum indicates that, in light of the audit report, grantee's request was considered a "claim for overexpended funds" and concurrence with the auditors' finding was considered as requiring denial of the request.

Grantee appealed the Financial Advisory Services Officer's decision to the ADAMHA Committee, which upheld the disallowance on August 17, 1978.

Policies

The project period system of funding, as relevant here, is described in this Department's Grants Administration Manual, Chapter 1-85, HEW TN 72.7 (6/30/72). Section 1-85-10 of Chapter 1-85 states:

The Project Period System is a technique developed by the Public Health Service...whereby projects are approved for multi-year support, but are funded in annual increments called budget periods. Funds surplus to the grantee's needs in one budget period are available for its use in in the next....

The procedure is described, in part, as follows:

If [a project is] approved for support, a grant is awarded in an amount estimated to be the necessary Federal share of costs for the first budget period. These funds are

available for use by the grantee, however, for the entire project period. It is, however, entirely appropriate for the operating agency to reduce future awards on the basis of apparent surpluses. Section 1-85-40 A.

Chapter 1-85 further states:

After completion of a budget period the grantee submits a report of expenditures. Any unobligated balance shown on the report of expenditures will, when added to the funds awarded for the current budget period, be compared with the operating agency approved budget for that budget period. Based upon this examination the operating agency may issue a revised award to either raise or lower the funding level, as appropriate to the approved budget.

The ADAMHA disallowance was based on the PHS Grant Policy Statement, DHEW Publication No. (OS) 74-50,000, dated July 1, 1974. This Policy Statement provides on page 8:

At the option of the awarding component, estimated or actual unobligated balances remaining at the end of a budget period may be treated in the following ways:

1. As an offset (deduction) from the continuation award, if there is one.
2. As a carryover for use in a subsequent budget period, as additional authority for purposes requested and justified in the continuation year application.
3. As a refund to the Government.

Grantee argued that its position that an unobligated balance in one budget period automatically carries over to the next is supported by the DHEW Federal Assistance Financial System Instruction Book (1974). This document states that the project period method of reporting "eliminates the problems of carryover of unexpended balances at the close of each budget period of support and automatically makes the balance available currently." (Section 7.0.) As the ADAMHA Committee pointed out, however, this statement is qualified by the sentence following it which states, "Use of these funds are governed by the approved operating budget or other policies of the DHEW Awarding Agencies."

Discussion

Both the Financial Advisory Services Branch, ADAMHA, and the ADAMHA Committee viewed this dispute as a question of whether the auditors' finding was correct and was based on a clear PHS policy. Accordingly, they based their

decisions on a determination that PHS policy was clear that authorization for use of carryover funds was required and that agency inaction could not be considered as authorization. In viewing the issues this narrowly, PHS failed to consider all of the relevant factors.

Nothing in the applicable policy statements requires that authorization be given prior to the expenditures. PHS could have given retroactive approval, revising grantee's award notices as requested by grantee in February 1977. The only apparent basis for denying this request was that the auditors had questioned grantee's use of carryover funds as expenditures in excess of the approved budgets. This reasoning is circular, however. If approval had been given in a timely manner, the auditors would not have questioned the costs.

This Board has taken the position in the past that it would not normally interfere in questions of approval of project expenditures where denial of approval is an exercise of programmatic judgment. Here, however, no programmatic reasons were given for denial of approval. Furthermore, although denial of approval may be a matter generally committed to the granting agency's discretion, it is nevertheless subject to certain standards.

Under the Administrative Procedure Act, courts will set aside agency action which is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 5 U.S.C. §706(2)(A). Applying this standard, the Supreme Court has stated that the court reviewing an agency decision "must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971). See, also, Bowman Transportation, Inc. v. Arkansas Best Freight Sys., Inc., 419 U.S. 281, 285-6 (1974).

In McNutt v. Hill, 426 F. Supp. 990 (D.D.C. 1977), the District Court for the District of Columbia found a determination of the Under Secretary of the Department of Housing and Urban Development (HUD) relating to discrimination in employment of a handicapped person to be arbitrary and capricious in two respects. The Under Secretary's decision relating to retroactive promotion and back pay for the employee discriminated against was defective "because no reasons for the conclusion were given." 426 F. Supp. at 1004. With respect to the issue of HUD's employment policy as a whole, the Court found the Under Secretary's failure to address the issue, due to a misunderstanding as to whether the employee's complaint had properly raised the issue, to be arbitrary and capricious. Courts have also overturned agencies' discretionary decisions if there is "no evidence to support the decision or if the decision is based on an improper understanding of the law." Digilab, Inc. v. Secretary of Labor, 357 F. Supp. 941 (D. Mass. 1973), remanded on other grounds 495 F. 2d 323, cert denied 419 U.S. 840.

Applying the guidance in case law, and considering the particular circumstances in this case, we have determined that the PHS decision was defective in that it failed to address the issue of whether retroactive approval should have been given, considering all of the relevant factors. Although an auditor's recommendations must be seriously considered by a program agency, an agency should not blindly adopt those recommendations where it is within the agency's power to remove the basis for the auditor's objections. As explained above, denial of retroactive approval because of the auditor's findings here involves circular reasoning.

Having decided that the PHS reasoning process was defective, however, we must next address the issue of what remedy is proper. Since approval is normally committed to agency discretion and since the record here is unclear as to whether the agency had programmatic reasons for denying approval, we have decided to remand this case to PHS for a determination as to whether retroactive approval should now be given. We suggest that this determination be made within 30 days of the date of this decision. It must be based on articulated reasons set forth in a written decision sent to the grantee and filed with the Board. If this determination is adverse to the grantee, or if it is unreasonably delayed, grantee may reopen its case with this Board for further review. If the Agency cannot show that there were programmatic reasons for denying approval, documented at the time, we might decide to reverse the disallowance. Cf. Operation SHARE Foundation, DGAB Docket No. 77-19, Decision No. 96, May 2, 1980.

In examining whether retroactive approval should be given here, PHS should bear in mind certain legal principles and factual considerations. First, the Administrative Procedure Act, in providing review of agency action which is "unlawfully withheld or unreasonably delayed," 5 U.S.C. §706(1), recognizes the harm which may be caused by agency failure to act in a timely manner. In addition, courts have established the principle that agency departure from its past practice may be arbitrary if not adequately explained Secretary of Agriculture v. United States, 347 U.S. 645, 652-3 (1954); F.T.C. v. Crowther, 430 F. 2d 510, (D.C. Cir. 1970). Here it is arguable that grantee relied on agency practice. The policy statements place responsibility for acting on the agency. Agency action, where taken, was either by means of an adjustment to a subsequent award notice, or by means of a much later transfer of the carryover to subsequent budget periods. Grantee's reports beginning with the 05 budget period showed grantee's use of the carryover funds. When it was called to grantee's attention that reliance on the agency's inaction might be misplaced, grantee promptly requested written authorization.

There are a number of other considerations in grantee's favor. Because grantee's funding was solely for staffing purposes, there was only one line item in grantee's budgets, i.e. "personnel services." Grantee

expended the carryover funds for these same purposes. For the entire eight-year project period, grantee spent less federal funds than the amount awarded. PHS is correct that budgets are "non cumulative," in that a problem of allocability arises where funds awarded for an earlier budget period are applied to costs incurred in a later budget period. This problem would never have arisen, however, if PHS had acted in a timely manner to adjust the award notices. Not having acted in a timely manner, PHS should not have refused retroactive approval later solely on the basis that the problem existed, where that very approval would have removed the problem.

We note also that PHS has not claimed that the funds were not expended for project purposes. With the relatively insignificant exception of \$2,550 identified as interest on federal funds which had not been repaid, the auditors found that grantee's accounting system and internal controls were generally acceptable. Grantee should, perhaps, have known that it should not have expended the carryover funds without explicit authorization to do so. The policy statements are not so clear, nor grantee's interpretation of the accounting system manual so unreasonable, however, as to warrant denial of retroactive approval solely on that basis.

In reaching our conclusion, we note that these circumstances are not likely to recur. Grantee here confused automatic carryover of funds with automatic authorization to spend the funds carried over. Under a revision to Chapter 1-85 issued in 1978, carryover of unobligated balances remaining at the end of a budget period would no longer be automatic under the project period system.

Conclusion

For the reasons stated above, we remand this case to PHS and request PHS to promptly issue a determination on whether to grant retroactive approval based on consideration of all the relevant factors. We note for the record that there is a \$2,288 difference between the total amount awarded and the total expenditures. Furthermore, although the parties have several times included in the appealed amount the \$2,550 questioned by the auditors as interest on federal funds, grantee specifically chose not to contest this finding at an earlier stage in this case. (Letter of June 20, 1978 from grantee to Administrator, ADAMHA.) If grantee ~~has~~ not already refunded these two amounts to the federal government, ~~grantee~~ should do so promptly.

/s/ Clarence M. Coster

/s/ Nell Minow

/s/ Norval D. (John) Settle, Panel Chair