Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Recovery Resource Center, Inc.
Docket No. A-06-78
Decision No. 2063

DATE: January 31, 2007

DECISION

Recovery Resource Center, Inc. (RRC), an Illinois not-for-profit corporation, appealed a decision by the Substance Abuse and Mental Health Services Administration (SAMHSA) to deny a noncompeting continuation award for the fourth and final year of RRC's project under the federal Recovery Community Services Program (RCSP). SAMHSA denied the continuation award based on its determination that RRC failed to comply with the terms and conditions of its RCSP awards. We conclude, based on the evidence and argument presented in this appeal, that RRC did in fact fail to comply with terms and conditions of its RCSP awards, and that this noncompliance was a reasonable and legally permissible basis to deny a continuation award for the final year of RRC's project.[1]

Background

The RCSP is authorized by section 509 of the Public Health Service Act, 42 U.S.C. § 2990bb-2. Under the RCSP, SAMHSA provides financial support to public and private non-profit organizations that provide "peer-driven" addiction recovery services. See RRC Ex. B.

In 2003, SAMSHA awarded a discretionary grant to RRC under the RCSP to develop and operate an addiction recovery support project in Oak Park, Illinois, a Chicago suburb. RRC Exs. A and B. On the initial (2003) Notice of Grant Award (NGA) for the project, SAMHSA indicated that it had approved a four-year "project

---

[1] The record of this case consists of: RRC's initial brief (RRC Br.) and an appeal file containing seven exhibits, labeled A through F; SAMHSA's response brief (Response Br.) and an appeal file containing 34 numbered exhibits; and RRC's reply brief (Reply Br.), to which RRC attached three additional exhibits (H, I, and J).

period" (April 30, 2003 to April 29, 2007) and that federal funding would be provided incrementally through annual "awards,"[2] with each award covering a 12-month "budget period." SAMHSA Ex. 3, at 1 (boxes 6-8, 11-12).[3] SAMHSA awarded $325,000 for the initial budget period (April 30, 2003 to April 29, 2004) of the project, indicating that the "recommended" level of annual support for the three succeeding budget periods would be the same ($325,000), "subject to the availability of funds and satisfactory progress of the project." Id. (Boxes 11-12).

The terms and conditions of RRC awards are identified in the NGA for each budget period. The NGA consists of a standard form showing (among other things) the approved annual budget (SAMHSA Ex. 3, at 1) and an attached list of "standard" and "special" award terms (id. at 2-6). According to the NGA, RRC's annual awards were subject to: (1) the terms in the attachment to the standard form; (2) applicable regulations in 45 C.F.R. Part 74; and (3) the Public Health Service (PHS) Grants Policy Statement in effect at the beginning of the applicable budget period. SAMHSA Ex. 3, at 1 (Box 16); id. at 2 (standard term no. 1). The applicable PHS Grants Policy Statement was issued in April 1994 and is included in the record as SAMHSA Exhibit 1.

When a grantee's project is funded incrementally, as RRC's was, there is no guarantee that the project will receive continued federal support after the initial budget period. SAMHSA Ex. 1, at 16-17. To obtain continued support, the grantee must, for each successive budget period, submit an application for "continuation" funding.[4] Id. at 13. In turn, the awarding agency may, for "justifiable reasons" — including the grantee's failure to comply with the terms of an award and lack of satisfactory progress in achieving project objectives –

---

[2] An "award" means "financial assistance that provides support or stimulation to accomplish a public purpose." 42 C.F.R. § 74.2.

[3] See also SAMHSA, HHS, *Notice of Funding Availability for Recovery Community Services Program (RCSP II)*, 67 Fed. Reg. 48,202 (July 23, 2002); Northwest Rural Opportunities, Inc., DAB No. 324 (1982) (discussing the denial of continuation funding for a multi-year project).

[4] This application is known as a "noncompeting continuation application" because the grantee does not compete with other projects for funding within the approved project period. SAMHSA Ex. 1, at 16.

discontinue funding the project. Id. at 52-53; see also Youth Network Council of Chicago, Inc., DAB No. 1150 (1990); Rio Bravo Ass'n, DAB No. 1161 (1990).

During the spring of 2004, SAMSHA's technical assistance contractors identified various "concerns" with RRC's financial management and corporate governance. SAMHSA Ex. 4. In April 2004, SAMSHA asked RRC to submit a "plan of correction" to address those concerns, indicating that technical assistance would be available to help RRC "improve its fiscal management and governance capabilities." Id. In May 2004, RRC's executive director, Cynthia Cameron, responded that RRC had implemented, or planned to implement, various corrective measures. SAMHSA Ex. 5.

Concerns about RRC's grant management surfaced again in 2005. On September 26, 2005, near the midpoint of the project's third budget period, SAMHSA designated RRC a "high-risk" grantee[5] pending the resolution of what SAMHSA called "significant internal control weaknesses and/or accounting system deficiencies."[6] RRC Ex. E at 1; RRC Ex. C at 3.

In accordance with the high-risk designation, SAMHSA imposed a "special award condition" prohibiting RRC from drawing on its allotment of federal funds without SAMHSA's prior written approval. RRC Ex. C at 3. SAMHSA also scheduled three site visits to oversee and assess RRC's performance. The first visit occurred on October 19-20, 2005, and focused on corporate governance issues. SAMSHA Ex. 11. The second visit, on October 31 and November 1, 2005, was made by a certified public accountant who assessed RRC's financial management. SAMSHA Ex. 12. The third visit, in January 2006, was made to verify RRC's compliance with the data collection requirements of the Government Performance and Results Act (GPRA). SAMSHA Ex. 16.

---

[5] The awarding agency may designate the grantee as a high-risk organization and impose "special award conditions" when it has reason to believe that federal funds may be at risk of loss or misuse due to the grantee's inexperience, poor performance, financial mismanagement, noncompliance with grant terms and conditions, or other circumstances. See 42 C.F.R. § 74.14; SAMHSA Ex. 1, at 15.

[6] The record does not reveal the source or specific nature of SAMSHA's concerns as of September 2005. RRC states that the high-risk designation "was a result of e-mail and telephonic reports from former RRC staff." RRC Br. at 3.

Throughout the final quarter of 2005, SAMHSA warned RRC that it had serious concerns about RRC's ability to manage the grant. SAMHSA Exs. 7, 8, 10. In a letter dated December 19, 2005, SAMSHA informed RRC that the first two site visits had "confirmed serious technical and fiscal weaknesses," including "fiscal mismanagement, lack of internal controls, breakdown of corporate governance infrastructure," and "unallowable expenditures." SAMSHA Ex. 15. So that it could "assess the extent of weaknesses that require[d] corrective action," SAMSHA asked RRC to respond to several questions and information requests contained in an attachment to the December 19th letter. Id. The letter stated that SAMHSA would, after reviewing RRC's response, "work with [RRC] on the development of a corrective action plan [to] address any outstanding issues." Id. SAMSHA asked RRC to submit a response to the letter by February 1, 2006. Id. Later, at RRC's request, SAMHSA extended the response deadline from February 1 to March 8, 2006. See SAMSHA Exs. 19 and 25; SAMHSA Br. at 5.

On March 8, 2006, RRC submitted a partial response to SAMSHA's December 19, 2005 letter. RRC Br. at 4; SAMSHA Ex. 25, at 2. On March 24, 2006, RRC sent a supplemental response containing answers to SAMHSA's questions regarding "programmatic" issues.[7] SAMSHA Ex. 25, at 2.

On April 6, 2006, SAMHSA held a conference call with RRC's executive director and the president of RRC's Board of Directors. RRC Ex. E at 1. During this call, SAMHSA indicated that its review of RRC revealed various operational "deficiencies" or "irregularities," including service delivery, financial management, corporate governance, and GPRA data collection and reporting. Id.; RRC Ex. F. Because of these problems, SAMHSA advised RRC during the conference call that it would deny RRC's application for continuation funding for the fourth (final) budget period of the project (April 30, 2006 to April 29, 2007) if RRC did not voluntarily relinquish its RCSP grant. RRC Ex. E.

RRC did not relinquish the grant. Accordingly, in a letter dated April 13, 2006, SAMSHA officially notified RRC of its decision to deny continuation funding for the fourth budget period of RRC's project under the RCSP. RRC Ex. E. This letter, which we refer to as the April 13th decision letter, outlined three general

---

[7] RRC alleged that it had requested a second extension, until March 24, 2005, to file its response to the December 19th letter but that SAMHSA failed to respond to the request. RRC Br. at 4. However, we can find no evidence in the record that RRC asked for a second extension.

areas of concern: (1) "fiscal management problems"; (2) "SF-270-draw-down problems"; and (3) "program performance problems." Id. at 2-3. Regarding the last concern, the April 13th decision letter states that, despite fourteen "TA [technical assistance] interventions" dating back to January 2003, RRC did not appear to have "an active and viable program of peer-to-peer recovery support services that warrants the amount of Federal funding that has been awarded and dispersed." Id. at 1, 3. In addition, the letter conveyed SAMHSA's belief that RRC would be unable, even with additional technical assistance, to perform its grant obligations "at an acceptable level in the near future." Id. at 1.

RRC promptly asked SAMHSA to reconsider its decision to deny continuation funding and allow an opportunity to correct the deficiencies. See RRC Ex. F. SAMSHA rejected this request, stating:

> You note that SAMSHA's December 19, 2005 letter, which requested information for our grant review, offered the possibility of working with you to develop such a plan. Our offer was based on the requirement that you submit your response by February 1, [2006], the due date specified in our letter. However, after requesting two extensions, you submitted an incomplete response on March 8. You subsequently submitted a supplemental response on March 24.
>
> Your failure to respond in a timely manner did not allow sufficient time for SAMSHA staff to work with you on a corrective action plan before the scheduled end of the grant year (April 29). More importantly, however, our review of the site visit reports and the information you submitted on March 8 and March 24 revealed such pervasive problems in so many different areas that we determined that it would not be possible to resolve them adequately even through an extensive corrective action plan.
>
> SAMSHA staff members have made every possible effort to assist you. The [SAMHSA] Project Officer and Division of Grants Management Specialist have devoted countless hours of technical assistance to help you with programmatic and fiscal/grants management issues. . . .
>
> At this point, we can only conclude that the technical assistance was not successful because your grant continues to evidence significant weaknesses and

> deficiencies. As stewards of Federal funds, it is our responsibility to provide oversight of the grants we fund. The information you have provided us leads us to conclude that your grant is not performing acceptably, and we have no choice but to disapprove your application for year 04 funds.

RRC Ex. F.

The April 13th decision letter did not inform RRC of its right to appeal the denial of continuation funding. Therefore, on May 16, 2006, SAMSHA sent RRC another letter reiterating its decision (and the reasons for it) and informing RRC of its appeal rights. RRC Ex. F.

<u>The parties' contentions on appeal</u>

On June 23, 2006, RRC filed its initial brief and exhibits in this appeal. RRC raises two issues in its initial brief. First, RRC contends that SAMHSA failed to comply with 45 C.F.R. § 74.90(c), which requires the awarding agency to give the grantee adequate notice of the basis for any final decision that adversely affects the grantee's interests. RRC Br. at 1, 7-12. Second, RRC contends that SAMHSA violated HHS policy by not giving it a reasonable opportunity to correct its deficiencies before disapproving a continuation award for the final budget period. <u>Id.</u> at 12-14.

On July 26, 2006, SAMHSA filed its response – a brief and 33 exhibits – to RRC's appeal. SAMHSA contends in its response brief that RRC received adequate notice of its reasons for denying continuation funding (Response Br. at 11-16), that RRC also received (but missed or wasted) an opportunity to correct its fiscal, governance, and programmatic deficiencies (<u>id.</u> at 26-27), and that those deficiencies warranted immediate enforcement action in any event (<u>id.</u> at 27-28). SAMHSA also contends that its decision to deny continuation funding may (and should) be sustained for any one of five reasons, including RRC's failure to comply with the terms and conditions of its awards under the RCSP. <u>Id.</u> at 16-26.

On September 11, 2006, RRC filed a reply to SAMHSA's arguments and evidence. SAMHSA filed a sur-reply on October 2, 2006.

<u>Discussion</u>

A. *SAMHSA's Motion for Leave to Supplement Appeal File is granted.*

Three days after it filed the sur-reply, SAMHSA filed a motion to include in the record (as SAMHSA Exhibit 34) the report of an audit of RRC performed by the HHS Office of Inspector General (OIG). The stated objective of the audit, which the OIG performed after the denial of continuation funding, was "to determine whether the grantee's costs incurred [for the period May 1, 2003 to April 29, 2006] complied with Federal financial and reporting requirements and were allowable, allocable, and reasonable under the terms of the grant and Federal regulations." SAMHSA Ex. 34, at 8. SAMHSA asserts on page two of its motion that the OIG's findings are "relevant to the issue of whether RRC has developed a financial management system that can provide '[e]ffective control over and accountability for all funds, property and other assets' and 'adequately safeguard all such assets and assure that they are used solely for authorized purposes'" (quoting 45 C.F.R. § 74.21(b)(3)).

RRC did not respond to SAMHSA's motion or ask the Board for leave to respond. We grant the motion because it is unopposed, and because the OIG audit report is relevant to the pending issues concerning RRC's alleged financial mismanagement.

B. *RRC received adequate notice of the bases for SAMHSA's decision to deny continuation funding.*

Title 45 C.F.R. § 74.90(d) requires that any "final decision" in a dispute affecting the interest of an award "recipient" must contain:

> (1) A complete statement of the background and basis of the awarding agency's decision, including references to the pertinent statutes, regulations, or other governing documents; and
>
> (2) Enough information to enable the recipient to understand the issues and the position of the HHS awarding agency.

RRC contends that SAMSHA's April 13th and May 16th decision letters do not comply with these requirements because they cite no law, regulation, or award condition to justify the denial of continuation funding, and because the letters' allegations of management weaknesses are too general and not supported by specific examples. RRC Br. at 9-13. In addition, RRC asserts that, prior to this appeal, SAMHSA did not provide it with copies of reports or documents describing the results of the 2005-2006 on-site reviews. Id. at 1.

SAMHSA responds that its decision letters should be viewed, not in isolation, but in light of all the parties' pre-decision correspondence and interaction. Response Br. at 11-14. Viewed in this broader context, SAMHSA says, the two decision letters were more than adequate to put RRC on notice of the basis for the decision to deny continuation funding. Id. SAMHSA also asserts — and we have held – that a notice requirement will be deemed satisfied if (1) the information and argument provided by the agency during the appeal of the agency's decision is adequate to put the grantee on notice of the basis for the decision and (2) the grantee has received an adequate opportunity to respond to the agency's presentation. Id. at 16; Vanderbilt University, DAB No. 903 (1987) (finding that "any alleged failure by the Agency to have fully and fairly explained the bases for the two preliminary decisions would have been cured by the extensive process provided to the University in its appeal before this Board").

We need not resolve RRC's arguments about the sufficiency of SAMHSA's decision letters because any insufficiency was cured by SAMHSA in this appeal. According to the PHS Grants Policy Statement, an awarding HHS agency may deny a noncompeting continuation award for the following "justifiable reasons":

1. A grantee is delinquent in submitting required reports.

2. Adequate Federal funds are not available to support the project.

3. A grantee fails to show satisfactory progress in achieving the objectives of the project.

4. A grantee fails to meet the terms of a previous award.

5. A grantee's management practices fail to provide adequate stewardship of Federal funds.

6. Any reason which would indicate that continued funding would not be in the best interests of the Government.

SAMHSA Ex. 1, at 52-53; see also SAMHSA Ex. 2, at 5 (HHS Grants Policy Directive § 3.07C.3). SAMHSA's response brief indicates that five of these six reasons — including delinquency in submitting required reports, failure to show satisfactory progress in achieving project objectives, failure to meet award terms and conditions, and failure to provide adequate stewardship of federal funds – were reasons for its decision to deny continuation funding, and that those reasons collectively showed that continued funding would “not be in the best interests of the Government.” Response Br. at 17-26. The response brief also specifies the facts and evidence supporting each reason. In addition, the response brief identifies the award terms and conditions that SAMHSA believes were violated. Finally, RRC does not contend or show that the response brief inadequately stated SAMHSA’s position on relevant issues. For these reasons, we find that the response brief provided a “complete statement of the background and basis of the awarding agency’s decision” and “[e]nough information to enable [RRC] to understand the issues and the position of the HHS awarding agency.” Furthermore, RRC had ample opportunity – more than one month – to respond to SAMHSA’s response brief and accompanying evidence. We therefore conclude that SAMHSA complied with section 74.90(c)’s mandate in this case.

We now turn to the merits of the challenged decision.

C. *RRC failed to comply with terms and conditions of its RCSP awards.*

Most of the reasons given by SAMHSA for its decision to deny continuation funding amount to allegations that RRC failed to comply with grant terms and conditions relating to financial management and reporting. The record before us substantiates those allegations.

The terms and conditions of RRC’s awards encompass the financial management and reporting requirements in 45 C.F.R. § 74.21. Among other things, section 74.21 requires the grantee to have a “financial management system” that:

- provides for “accurate, current and complete disclosure of the financial results of each HHS-sponsored project in accordance with the reporting requirements set forth in § 74.52” (45 C.F.R. § 74.21(b)(1));

- has “[r]ecords that identify adequately the source and application of funds for HHS-sponsored activities” (45 C.F.R. § 74.21(b)(2)); and

- provides for "[e]ffective control over and accountability for all funds, property, and other assets" (45 C.F.R. § 74.21(b)(3)).

In addition, section 74.21 requires an award recipient to "adequately safeguard all such assets and assure they are used solely for authorized purposes." 45 C.F.R. § 74.21(b)(3). RRC's obligation to prudently manage and safeguard federal funds is also stated in the NGA:

> As the grantee organization, you acknowledge acceptance of the grant terms and conditions by drawing or otherwise obtaining funds from the Payment Management System. In doing so, your organization must ensure that you exercise prudent stewardship over Federal funds and that all costs are allowable, allocable, and reasonable.

SAMHSA Ex. 3, at 4 (paragraph no. 17).

SAMHSA asserted that the following deficiencies or shortcomings indicated that RRC had failed during the project period to comply with section 74.21 and other related grant terms:

1. Failure or inability to account for $130,000 in expenditures (Response Br. at 17-20);

2. Failure to submit a required Financial Status Report (FSR) within the time period prescribed by the regulations (id. at 20);

3. Failure to implement a SAMHSA quality assurance recommendation that the corporation's checks be signed by two persons instead of one (id. at 22);

4. Use of federal funds for unallowable expenses such as charges for department store items, local restaurants, and entertainment (id. at 22-24);

5. Issuance of bad checks that generated over $400 of overdraft charges for the first year of the grant, more than $100 for the second year of the grant, and more than $700 for the third year of the grant (id. at 23);

6. Use of federal funds to make unallowable "organizational" expenditures, including payment of fees to an unrelated organization for incorporating RRC and helping it secure tax-exempt status (id. at 23-24);

7. Failure to justify “questionable” or possibly unallowable expenditures, including: $1,600 for a 30-inch LCD television; $1,000 in video games, video game consoles, and video game input devices; $750 for a charity golf event; $630 for a cell phone/PDA; $3,600 in “cell phone stipends” to the organization’s executive director and director of operations; and hundreds of dollars for a treadmill, stair-stepper, and stationary bike (id. at 24).

RRC does not respond – or does not satisfactorily respond – to these specific allegations. For example, RRC does not deny that it issued bad checks generating approximately $1,200 in overdraft fees (see item 6 above). In addition, RRC does not deny that it failed to implement a policy recommended by SAMHSA’s project officer which required that corporate checks be signed by two employees (see item 3 above). Although RRC agreed to implement the two-signature policy in May 2004 after SAMHSA raised concerns about RRC’s financial management, the record shows that RRC later abandoned the policy for unknown reasons. SAMHSA Ex. 4, at 3; SAMHSA Ex. 5, at 1 (¶ A.2); SAMHSA Ex. 11, at 13. The record also shows that, as of mid-October 2005, only one RRC employee – executive director Cynthia Cameron – had signature authority, and “[b]ecause [Cameron] [was] seldom in the office, others actually sign[ed] checks in her name over their initials on a routine basis.” SAMHSA Ex. 11, at 13 (report of the October 19-20, 2005 site visit). These practices are clear evidence of weakness in RRC’s ability to manage, account for, and otherwise safeguard federal funds, and RRC has made no effort to show otherwise.

Additional evidence of weakness in RRC’s cash management appears in the report of the October 31-November 1, 2005 site visit. SAMHSA Ex. 12. According to that report, executive director Cynthia Cameron presented SAMHSA’s site reviewer with an affidavit alleging that a RRC employee had forged five of the organization’s checks. Id. at 5-6. The site reviewer attributed the alleged forgery, and the resulting misappropriation of federal funds (which RRC apparently recovered), to a “general lack of internal controls on the part of the Board of Directors, the staff and the bank[.]” Id. at 6.

The record also confirms that RRC failed to file a required financial report on time (see item 2 above). Award terms required RRC to submit an annual FSR within 90 days after the close of each budget period. 45 C.F.R. §§ 74.52(a)(1)(iv), 74.21(b)(1) (requiring adherence to reporting requirements in section 74.52); SAMHSA Ex. 3, at 4 (stating that the annual FSR "is due within 90 days after expiration of the budget period"). The FSR for the second budget period, April 30, 2004 to April 29, 2005, was due on or about July 31, 2005. SAMHSA Ex. 28. RRC admits that it failed to submit the FSR until April 2006, almost eight and one-half months after this deadline, but suggests that the oversight was not significant. Reply Br. at 7. We disagree. Submission of a FSR is no mere formality or technicality. It is an accounting of project expenditures that helps the awarding agency determine whether the grantee is managing federal funds responsibly. Timely submission of the FSR was especially important here because SAMHSA had identified RRC (both in the spring of 2004, and in the fall of 2005) as having significant financial management deficiencies. Utica Head Start Children and Families, Inc., DAB No. 1749, at 31 (2000) ("Timely submission of the annual FSR was particularly significant under the circumstances here when Utica's fiscal operations were subject to charges of mismanagement and improprieties."). The unexplained failure to submit the FSR on time suggests that RRC either carelessly ignored its responsibilities under the grant or lacked internal policies and procedures designed to ensure that it complied with federal requirements.

SAMHSA alleges that the FSR submitted by RRC in April 2006 for the second budget period was not only late but inaccurate because it failed to account for approximately $130,000 in project expenditures (see item 1 above). The record supports a finding that the FSR failed to account for at least $108,506.65 in expenditures. The FSR indicated that $108,506.65 of the $325,000 awarded for the second budget period remained unspent ("unobligated") at the end of the period.[8] SAMHSA Ex. 29. However, SAMHSA introduced evidence, which RRC does not question, purporting to indicate that RRC had withdrawn – and presumably spent – all available funds from HHS's Payment Management System for the second budget period. SAMHSA Ex. 32, at 1. In short, there is an apparent discrepancy between RRC's FSR, which shows $108,506.65 in unspent award funds for the second budget period, and HHS records indicating that RRC had actually spent those funds. At best, the discrepancy, which RRC's executive director acknowledged in correspondence (SAMHSA Ex. 31), is evidence that RRC could not generate "accurate, current and complete disclosure" of its financial results, as required by section 74.21(b)(1). At worst, it suggests that RRC was unable to account for $108,506.65 in expenditures during the second budget period. Being able to account for the expenditure of federal

[8] The FSR indicated that RRC was reporting its "outlays" (or disbursements) on a "cash" basis. SAMHSA Ex. 29 (Box 7).

funds is a central responsibility of any grantee. See Kuigpaymiut, Inc., DAB No. 1780, at 3 (2001) ("A grantee must account for all grant funds received by documenting that it incurred and actually paid the program-related expenditures"); Oklahoma Office of State Finance, DAB No. 1668 (1998) (a grantee has the burden of documenting that an expenditure of grant funds is allowable).

Although RRC does not deny that the FSR it submitted in April 2006 failed to account for a substantial amount of expenditures made with project funds, it contends that the discrepancy is now irrelevant because it later submitted revised FSRs in connection with the closeout of its grant. According to RRC, the revised FSRs resolved or reconciled all outstanding discrepancies. Reply Br. at 6-7.

We see no need to evaluate the sufficiency or accuracy of the revised FSRs. The issue is whether, at the time SAMHSA made its decision to deny continuation funding, RRC had a financial management system in place that provided for "[a]ccurate, current, and complete disclosure of financial results . . . in accordance with" applicable reporting requirements. 45 C.F.R. § 74.21(b)(1). The late submission of a FSR that failed to account for the expenditure of more than $108,000 in grant funds is strong evidence that RRC did not have such a financial management system when SAMHSA denied the continuation award. Furthermore, we agree with SAMHSA that the revised FSRs (submitted in August 2006) raise additional troubling issues, such as whether RRC spent federal funds in violation of the special award condition imposed because of its high-risk status, and whether RRC spent federal funds that had not been approved for carryover from previous budget periods.

Contributing to the portrait of financial mismanagement was RRC'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 (see items 4 and 6 above).[9] RRC does not deny SAMHSA's assertion that it used federal funds for unallowable department store purchases, local restaurant meals, and "entertainment" expenses. Response Br. at 22-23; Reply Br. at 9-10. Instead, RRC asserts that SAMHSA did not adequately identify those unallowable expenditures. Reply Br. at 9. We disagree. Quoting the May 16th decision letter, SAMHSA's

---

[9] See Kuigpaymiut, Inc. (costs must be necessary and reasonable for performance of the award; federal grant funds may be spent only for grant purposes).

response brief states that RRC used grant funds for “department stores, local restaurants, convenience stores, and entertainment.” Response Br. at 22-23. The brief also identifies specific examples, either by describing them in the narrative or by pointing to documents in its appeal file that reflect expenditures of these types.[10]

RRC also did not wholly refute evidence that grant funds were used to pay unallowable “organization costs” (see item 6 above). Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, whose provisions are terms of RRC’s awards,[11] states in relevant part:

> *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

OMB Circular A-122, Att. B, ¶ 31. In its December 19, 2005 letter, SAMHSA asked RRC to provide copies of three checks – check 2168 for $2,500, check 2169 for $1,500, and check 2172 for $2,500 – that were identified in RRC’s accounting records as payments for “organization costs.” SAMHSA Ex. 15, at 2, 3; see

[10] SAMHSA submitted contemporaneous records, such as credit card statements, of what it believed were the unallowable expenditures. SAMHSA Ex. 23, at 4 (showing payment of $75.36 to Second City, a Chicago comedy club, on February 17, 2004 and a charge of $140.00 on February 10, 2004 for an unidentified entertainment ticket purchase); SAMHSA Ex. 21, at 1 (profit-and-loss statement showing $126.66 in “entertainment” expenses during the second budget period); SAMHSA Ex. 23, at 2 (credit charge of $59.24 for purchase of an unidentified item at Lord & Taylor department store); SAMHSA Ex. 23, at 4 (credit card charges of $30.15, $59.96, $47.35 for meals at Chicago-area restaurants in February 2004).

[11] See SAMHSA Ex. 1, at 2 (indicating that award terms include the authorities listed in Box 16 of the NGA, including 45 C.F.R. Part 74); 45 C.F.R. § 74.27(a) (stating that the “allowability of costs incurred by nonprofit organizations . . . . is determined in accordance with the provisions of OMB Circular A-122).

also RRC Ex. I, at 2. The payee on checks 2168 and 2169 was Cynthia Cameron, RRC's executive director; the payee on check 2172 was Yellow Brick Road, an addiction recovery home operated by Cameron. RRC admits that check 2169 for $1,500 was used for unallowable start-up costs and other incorporation expenses. See Reply Br. at 9; see also SAMHSA Ex. 24, at 29. RRC claims that check 2168 — for $2,500, payable to Cynthia Cameron — was not, in fact, a payment for organization costs but instead was payment for office space that RRC rented from Yellow Brick Road during the first five months of RRC's project (May through September 2003). Reply Br. at 9-10. However, the available evidence suggests that payment of these rental costs was made by check 2165 (for $3,500, payable to Cameron), not check 2168. See SAMHSA Ex. 24, at 28-29. Furthermore, the only evidence of the office space arrangement between Yellow Brick Road and RRC is a letter from Cameron to RRC requesting rent reimbursement, a letter written more than 18 months after the purported rental period.[12] Id. at 29.

SAMHSA questioned the allowability of various other expenditures (see item 7 above), including payment of registration fees for a charity golf event ($630) and purchases of a 30-inch LCD television ($1,600), video games and accessories (more than $1,000), exercise machines costing thousands of dollars each, a cell phone-personal digital assistant ($630), and cell phone "stipends" ($3,600). Response Br. at 24. RRC has made no effort to show that any of these expenditures were necessary and reasonable costs of carrying out its peer-based addiction recovery project.[13] See Reply Br. at 9-10. Instead, RRC

---

[12] Relying on a portion of its general ledger, RRC claims that check 2172 constituted a duplicate payment for the rental costs covered by check 2168. Reply Br. at 9. Although the ledger does not confirm that check 2172 was a payment for rent, the ledger and other records indicate that the payment was cancelled or reversed. RRC Ex. I, at 2, 4, 6.

[13] RRC suggests that the expenditures for exercise equipment, video equipment, and video games were allowable because the grant solicitation under which it received the award lists "physical education and fitness" activities, and "alcohol- and drug-free social/recreational activities" such as "movie nights" and "game nights," as examples of "recovery community peer support services." Reply Br. at 10 (citing RRC Ex. J). Although we agree that costs of physical fitness and social or recreational activities may be allowable under a RCSP grant, the

(continued...)

complains that SAMHSA offered no evidence that the questioned expenditures were not grant-related. Id. at 10. But SAMHSA was under no such obligation. Once the agency questions the allowability of particular expenditures, as it did here, the burden falls on the grantee to demonstrate that the expenditures were allowable. 45 C.F.R. § 74.21(b)(7) (requiring the grantee to have a financial management system that maintains accounting records supported by source documentation); OMB Circular A-122, Att. A, ¶ A.2.g (stating that costs must be "adequately documented" in order to be allowable); Northstar Youth Services, DAB No. 1884 (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"); Northstar Youth Services, DAB No. 1788 (2001) (rejecting the grantee's assertion that SAMHSA bore the burden of showing the validity of a disallowance of grant expenditures).

The findings of the OIG audit corroborate SAMHSA's determination that RRC lacked an adequate system of financial management and failed to safeguard and account for its use of federal funds and assets. Based on its review of grant expenditures during the project period, the OIG found the following:

- SAMHSA lacked an "adequate financial management system to accumulate and record costs."

- RRC "submitted FSRs for the 3-year period ending April 30, 2006, that did not reconcile to the grantee's official accounting records . . . Although the grantee claimed $1,012,838 over the 3-year period, accounting records reported costs

---

[13](...continued)
fact that the questioned expenditures arguably fall within these general categories is not proof that they were necessary and reasonable for the operation or performance of RRC's grant. To carry its burden of showing that the costs were allowable, RRC needed to submit evidence that the costs were necessary for the operation of its unique peer-driven recovery support program and otherwise "reasonable" in amount, scope, and purpose. See OMB Circular A-122, Att. A, ¶¶ A.2, A.3 (stating that costs must be "reasonable for performance of the award and allocable thereto"); Columbus County Services Management, Inc., DAB No. 1567, at 3 (1996) (citing the PHS Grants Policy Statement provision stating that all costs must be "necessary and reasonable"). RRC did not submit or point us to any such evidence.

incurred of only $899,407, a difference of $113,431."

- RRC drew down the entire $975,000 in grant funds awarded for the first three budget periods of the grant. However, RRC's accounting showed only $899,407 of incurred costs for the same period, a difference of $75,593.

- The grantee incurred costs that were not recorded in its books of record.

- RRC incurred unallowable or unjustified costs totaling $14,088 during the three years of the grant.

- RRC did not adequately safeguard equipment purchased with federal grant funds. During the audit, RRC could not present for inspection over 40 percent of the items listed in its inventory record. In addition, RRC did not keep accurate and complete equipment records.

SAMHSA Ex. 34.

The OIG's audit findings are consistent with the general findings of the October 31-November 1, 2005 on-site review, which also looked closely at RRC's financial management. The report of that on-site review characterized RRC's "financial management structure" as "unstable" and concluded that RRC did not have "adequate internal controls or fiscal policies and procedures to provide reasonable assurances that RCSP Grant Funds are expended in accordance with the terms and conditions of the . . . grant award." SAMHSA Ex. 12, at 6, 9. The report also stated that the "financial management infrastructure" was "so dysfunctional" that RRC could not adequately manage its grant, noting that the "internal controls needed to ensure compliance with Federal grant regulations [had] been deconstructed due to the internal discord among the Staff and Board [of Directors]." <u>Id.</u> at 10. That discord was described more fully in the report of the October 19-20, 2005 on-site review, which found serious lapses in corporate governance, including a non-functioning Board of Directors. SAMHSA Ex. 11, at 17 (stating that RRC's Board of Directors was "in disarray" during the site visit, and that "embedded within the current state of affairs [was] dissatisfaction with the Executive Director's management of the organization and the grant on the part of a number of the Directors"). That RRC lacked a functioning Board of Directors, one that diligently exercised its proper role to oversee the financial affairs of the organization,[14] only increased the risk that federal funds would be lost or wasted.

In addition to supporting the allegations of financial mismanagement, the record supports SAMHSA's finding that RRC failed to show satisfactory progress in achieving the objectives of its addiction recovery project. In its April 13th decision letter, SAMHSA stated that "documentation RRC provided on programmatic performance did not offer evidence of an active and viable program of peer-to-peer recovery support services that warrants the amount of Federal funding that has been awarded and disbursed." RRC Ex. E, at 3. That statement is supported by the uncontested findings of the agency contractor who performed the January 2006 on-site review. The contractor found that the primary elements of RRC's addiction recovery program were "peer coaching," "recreational recovery," and "recovery education and administration" but found little evidence that RRC was focused on providing these services:

> The day-to-day activities of the program seem to focus around client access to the computers and telephones [to help clients gain employment]. The program's primary goals of peer coaching, recreational recovery, and recovery education and information are rarely identified as elements of the program's events and daily sign-in rosters. Another concern is the program's hours. Currently, the program's regular business hours are between 10 a.m. and 4 p.m. — a total of 30 hours per week. The program does not have evening hours to accommodate clients so that they may continue to participate in the program if they obtain daytime employment.

Id.

RRC makes no attempt to explain these apparent programmatic shortcomings, nor does it assert that, as of January 2006, the 32nd month of its 48-month project, acceptable progress had been made in fulfilling the project's stated goals or purposes. We

---

[14] Renaissance III, DAB No. 2034 (2006) ("As the corporation's governing authority, [the grantee's] Board of Directors was responsible for adopting sound managerial policies, retaining necessary and competent personnel (such as a corporate treasurer), overseeing the financial affairs of the corporation, and assuring compliance with applicable law").

also note that SAMHSA had no reliable means to verify the project's effectiveness or efficiency because, as SAMHSA alleges and the record shows, RRC failed to comply fully with its obligation to collect performance data required by the Government Performance and Results Act (GPRA).[15] Collection of GPRA data was one of the terms and conditions of RRC's grant. SAMHSA Ex. 3, at 5. RRC's failure to document program performance and otherwise show that it was meeting the grant's fundamental objective – to provide a peer-driven support program that promoted long-term and sustained recovery from substance addiction – is further evidence of noncompliance with grant terms and conditions. See Action for Youth Christian Council, Inc., DAB No. 1651, at 8 (finding that the grantee "materially failed to comply with the terms of the grant award because it failed to form a community coalition or otherwise make progress on project goals"); Tuscarora Tribe of North Carolina, DAB No. 1835 (2002); American Indian Center of Omaha, Inc., DAB No. 1141 (1990).

---

[15] The report of the January 2006 on-site review summarized the findings regarding RRC's GPRA data as follows:

> On the basis of the completion of the GPRA audit, the integrity of the program's GPRA data is in question. There are many inconsistencies and inaccuracies in the data collection process and the documentation of the GPRA interview data. The data entered on the hard copy interview forms do not match the data entered into the database system. The program's GPRA data collection process is not consistent with [SAMHSA] policies and regulations. The audit results suggest that there may be some improprieties in the manner in which GPRA interviews have been conducted and the quality of the data entered, both on the hard copy interview forms and the data entered into the database system. Staff members should not continue to follow the same practices for collecting interview data and entering data into the computer system. Although this behavior may be associated with past employees, current employees do not have a clear understanding about the GPRA protocols and procedures. None of the current staff involved with GPRA data collection has received formal training, and the program has no policy for them to learn proper methods of conducting GPRA interviews and collecting data, or maintaining the data.

SAMHSA Ex. 16, at 7.

In short, we conclude, based on the evidence and argument presented, that RRC failed to comply with the terms and conditions of its RCSP awards.

3. *RRC was not entitled to a further opportunity to correct.*

As indicated, RRC contends that SAMHSA did not give it a reasonable opportunity to correct its noncompliance before deciding to deny continuation funding. RRC Br. at 12-13. RRC contends that HHS Grants Policy Directive (GPD) 3.07 requires SAMHSA to give the grantee an opportunity to correct, and that SAMHSA was legally bound to follow GPD 3.07's mandate. RRC Br. at 12-13. For these reasons, RRC says, the Board should reverse the decision to deny continuation funding and remand the case to SAMHSA with instructions to allow RRC an opportunity to correct its deficiencies within a reasonable period of time. Id.

We disagree that GPD 3.07 required SAMHSA to offer RRC any further opportunity to correct in these circumstances. GPD 3.07 sets out HHS policies regarding "enforcement" actions that may be taken in the event of a grantee's noncompliance with award terms and conditions. SAMHSA Ex. 2. Section 3.07B.3 states that the awarding agency should advise the grantee of any problems discovered during the review or monitoring process, and that "the grantee should . . . be given the opportunity to correct them, as appropriate." Id. (emphasis added). The words "as appropriate" clearly suggest that, in a particular case, the awarding agency may elect not to provide that opportunity if it determines that circumstances demand immediate action. What is implicit in section 3.07B.3 is made explicit in sections 3.07B.4 and 3.07B.6, which indicate that the agency may take "immediate action," including terminating the grant, if such action is "necessary to protect the interests of the Government and the public." Id. (emphasis added).

This interpretation of GPD 3.07 is consistent with relevant provisions of the PHS Grants Policy Statement. Like GPD 3.07, the Grants Policy Statement uses no absolute or mandatory language; it states that the awarding agency "prefers that deficiencies will be corrected whenever practicable" and that PHS will "normally . . provide sufficient opportunity for [deficiencies] to be corrected." SAMHSA Ex. 1, at 52 (emphasis added).

For these reasons, we conclude that SAMHSA had the authority and discretion to take immediate enforcement action without giving RRC an opportunity to correct. Furthermore, it is apparent that SAMHSA did, in fact, give RRC an opportunity to correct. When it discovered deficiencies in late 2005, SAMHSA did not immediately terminate RRC's grant. In its December 19, 2005 letter, SAMHSA stated that it would help RRC formulate a corrective action plan based on information that it was asking RRC to provide. However, RRC did not send a complete response to SAMHSA's information request until March 24, 2005, only five weeks before the start of the final budget period. At that point, SAMHSA decided that there was insufficient time to take corrective action before the start of the new (and final) budget period. SAMHSA also concluded that RRC was not likely to achieve an acceptable level of performance "in the foreseeable future," even with additional technical assistance and an "extensive" corrective action plan. RRC Ex. E at 1; RRC Ex. F.

SAMHSA's decision to cut off RRC's opportunity to correct at that point was not unreasonable. As discussed above, the record confirms that RRC had serious financial management and programmatic deficiencies that SAMHSA concluded were not amenable to quick remediation. The effectiveness of RRC's addiction recovery program was also in question. In addition, the October 19-20, 2005 site visit revealed that RRC was plagued with inadequate and dysfunctional corporate governance, a problem that had persisted despite prior infusions of technical assistance. See SAMHSA Exs. 4, 5 (at 2), 11 (at 17). That same site visit raised serious questions about the managerial competence of RRC's executive director as well as her commitment to follow federal requirements. See, e.g., SAMHSA Ex. 11, at 16. Although RRC knew that SAMHSA was deeply concerned about its performance under the grant, RRC exhibited no urgency or desire to take quick and effective remedial action in late 2005 or 2006; indeed, it took RRC three months just to respond to SAMHSA's December 19, 2005 information request. RRC also had a history of failing to implement corrective action proposed by SAMHSA (e.g., abandonment of the two-check policy). Given these circumstances, SAMHSA was justified in concluding that the likelihood of prompt and successful corrective action was slim, if not nonexistent.

RRC contends that SAMHSA could have considered RRC's March 24, 2006 submission, helped RRC fashion a plan of action to correct the noncompliance, and approved continuation funding for the final year of the project while retaining the ability to suspend or terminate that funding if RRC's corrective action failed to achieve desired results. Reply Br. at 12. RRC also suggests that any risk of loss of federal funds was insignificant, and therefore did not warrant cut-off of financial support, because RRC was receiving funding on a cost reimbursement basis due to its designation as a high-risk grantee. Id. At best, these contentions suggest that SAMHSA may have had more than one reasonable course of action available to deal with the noncompliance. At worst, they ignore the possibility – more realistically the likelihood – that RRC, given its pervasive and myriad problems, would be unable to attain compliance within a reasonable period of time, even with federal help and oversight. When a basis exists to take enforcement action, an awarding agency may opt for the approach that best serves the interest of the government and taxpayers. With respect to RRC, SAMHSA evidently concluded that the risk of continued deficient performance was too great to justify the additional costs – including investment of agency staff time and technical assistance – that would have been incurred to allow RRC to continue operating with federal support. Given all that has been discussed, we conclude that SAMHSA's decision is amply supported by the record and the applicable law.

Conclusion

The record substantiates SAMHSA's determination that RRC failed to comply with terms and conditions of its RCSP awards. Furthermore, RRC does not dispute SAMHSA's assertion that an awarding agency may deny continuation funding because of noncompliance with grant terms and conditions, nor has RRC persuaded us that denying continuation funding was an unreasonable enforcement action in light of the evidence of noncompliance. Accordingly, we affirm SAMHSA's decision to deny a continuation award for the fourth budget period of RRC's project under the RCSP.

/s/
Judith A. Ballard

/s/
Donald F. Garrett

/s/
Leslie A. Sussan
Presiding Board Member