

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

Middletown Community Health Center, Inc.
Docket No. A-16-79
Decision No. 2754
December 15, 2016

DECISION

Middletown Community Health Center, Inc. (MCHC) appeals in part the March 16, 2016 determination of the Health Resources and Services Administration (HRSA) disallowing \$109,212 that MCHC charged to a grant HRSA awarded. HRSA awarded the grant under the American Recovery and Reinvestment Act of 2009 (ARRA) Capital Improvement Program (CIP). MCHC appeals HRSA's disallowances of \$35,000 in paving costs and \$69,015 for force account labor costs.¹

For the reasons set out below, we sustain the disallowances.

I. Background

A. The CIP award

HRSA is an operating division (OPDIV) of the federal Department of Health and Human Services (HHS) that, among other things, administers certain grants to health centers. Title VIII of ARRA made federal funding available for "grants for construction, renovation, and equipment, and for the acquisition of health information technology systems, for health centers including health center controlled networks receiving operating grants under section 330 of the [Public Health Service] Act[.]" Pub. L. No. 111-5, 123 Stat. 115 (2009).

MCHC is a nonprofit, full-service community health center with 10 diagnostic and treatment locations in New York State and Pennsylvania. HRSA Br. at 2. On June 25, 2009, HRSA issued ARRA CIP award C81CS13877 in the amount of \$763,415 to MCHC to renovate and repair several facilities and to purchase information technology

¹ The disallowance included \$5,197 in unidentified costs that HRSA disallowed for lack of sufficient documentation, which MCHC initially appealed. MCHC subsequently indicated in its brief, however, that it would not pursue its appeal of this amount, which "was derived from previous submissions and was part of the already determined unallowable costs." MCHC Br. at 2. Accordingly, we sustain the disallowance of \$5,197 in unidentified costs without further discussion.

equipment. HRSA Ex. 1. The award notice explained that payments under the award would be made available through the HHS Payment Management System. *Id.* at 17. The original two-year project and budget period was June 29, 2009, through June 28, 2011. On June 24, 2011, HRSA extended the project period through June 30, 2012. HRSA Ex. 2.

B. Applicable Grant Requirements

Nonprofit recipients of federal grants are bound by the uniform administrative requirements governing HHS awards at 45 C.F.R. Part 74, which incorporates by reference the cost principles in OMB (Office of Management and Budget) Circular A-122, codified at 2 C.F.R. Part 230.² 45 C.F.R. §§ 74.1(a), 74.27. In addition, grant award notices specify the terms and conditions with which grantees must comply. The award notice for MCHC's CIP grant explained that MCHC was required to comply with Part 74, the HHS Grants Policy Statement (GPS),³ and specified terms and conditions for ARRA grants. HRSA Ex. 1, at 12-18. MCHC was "responsible for contacting [its] HHS grant/program managers for any needed clarifications." *Id.* at 12.

Part 74 requires that a recipient of federal funds have a financial management system that provides for "[r]ecords that identify adequately the source and application of funds for [grant] activities" as well as "[a]ccounting records, including cost accounting records that are supported by source documentation." 45 C.F.R. § 74.21(b)(2), (b)(7). The award notice for MCHC's CIP grant similarly states that "in accordance with 45 CFR 74.21. . . , recipients agree to maintain records that identify adequately the source and application of Recovery Act funds." HRSA Ex. 1, at 13. In addition, the GPS provides that nonprofit recipients must maintain financial management systems that meet the standards in 45 C.F.R. § 74.21 and "enable the recipient to . . . [m]aintain records that adequately identify the . . . purposes for which the award was used, including . . . [a]ccounting records [that are] supported by source documentation such as canceled checks, paid bills, payrolls, and time and attendance records." GPS at II-59.

² We cite to the 45 C.F.R. Part 74 regulations and the OMB Circular A-122 provisions in 2 C.F.R. Part 230 in effect when HRSA awarded the grant at issue here. In December 2013, after the award period, the OMB consolidated the content of OMB Circular A-122--which was codified at 2 C.F.R. Part 230--and seven other OMB circulars into one streamlined set of uniform administrative requirements, costs principles, and audit requirements for federal awards, currently published in 2 C.F.R. Part 200. *See* 78 Fed. Reg. 78,590 (Dec. 26, 2013). Effective December 26, 2014, Part 74 of title 45 of the Code of Federal Regulations was superseded by the "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards" published in 45 C.F.R. Part 75. *See* 79 Fed. Reg. 75,871, 75,889 (Dec. 19, 2014).

³ The GPS contains policy and interpretive guidance regarding grant terms and conditions that are common across all HHS operating divisions. GPS at i. The 2007 version of the GPS in effect when the grant was awarded can be accessed from <http://www.hhs.gov/grants/grants/grants-policies-regulations/index.html#>

Grantees also are responsible for maintaining documentation “to account for the receipt, obligation and expenditure of [grant] funds.” 45 C.F.R. § 74.22(i)(1). Section 74.28, titled “Period of availability of funds,” provides: “Where a funding period is specified, a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the HHS awarding agency pursuant to § 74.25(d)(1).” Section 74.25(d)(1) states that the “HHS awarding agency” may grant waivers “authorizing recipients to ... [i]ncur pre-award costs ... more than 90 calendar days [prior to award] with the prior approval of the HHS awarding agency.”

The Notice of Award for MCHC’s CIP grant included the following term: “For HRSA funding being provided under [ARRA], ... HRSA is permitting a grantee to incur pre-award costs up to 90 calendar days prior to the award of a Federal grant with the prior approval of the HRSA Grants Management Officer. . . . If pre-award costs are incurred and the proposed award is issued, these costs may be permitted as long as they are otherwise included in the application, are allowable costs under the authorizing legislation and were not incurred prior to enactment of [ARRA], February 17, 2009.” HRSA Ex. 1, at 7-8. The award notice further stated: “Items that require prior approval from the awarding office as indicated in 45 CFR Part 74.25 ... must be submitted in writing to the Grants Management Officer (GMO). Only responses to prior approval requests signed by the GMO are considered valid.” *Id.* at 17.⁴

To be allowable charges, a grantee’s costs must be “reasonable for the performance of the award and be allocable thereto under these principles” as well as be “adequately documented.” 2 C.F.R. Part 230, App. A, ¶ A.2.a and g. The Board has consistently held that “under the applicable regulations and cost principles, a grantee bears the burden of documenting the existence and allowability of its expenditures of federal funds.” *Suitland Family & Life Dev. Corp.*, DAB No. 2326, at 2 (2010) (citation omitted). Similarly, the Board has stated that “[o]nce 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 Servs., Inc.*, DAB No. 1884, at 5 (2003)

⁴ OMB Circular A-122, Cost Principles for Non-Profit Organizations, made applicable by 45 C.F.R. § 74.27(a), states that:

Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

(citations omitted). The Board has also held that a grantee's burden to document the existence, allowability and allocability of its federal expenditures means that "the grantee has the burden to document that its expenditures of grant funds were made in support of grant objectives and in compliance with the terms and conditions of the grant." *Tuscarora Tribe of North Carolina*, DAB No. 1835, at 10-11 (2002) (citation omitted).

C. The limited scope review and disallowance

To determine whether MCHC's costs were allowable, reasonable and allocable under federal regulations and the terms of MCHC's CIP award, the HRSA Office of Federal Assistance Management, Division of Financial Integrity (DFI) conducted a limited scope review (LSR) of MCHC's award. In a draft report provided to MCHC on August 26, 2014, DFI concluded that \$171,727 of MCHC's costs were unallowable. HRSA Ex. 3, at 2. In response, MCHC provided additional documentation to support some of those costs. *Id.*

DFI concluded in its March 27, 2015 final report that MCHC drew down \$763,415 from the Payment Management System and charged \$595,053 in allowable costs to the award. *Id.* Consequently, DFI concluded, MCHC was required to return \$168,362, the difference in the amounts, to HRSA. *Id.* The report concluded, among other things, that \$35,000 for paving parking lots and repairing pavement was unallowable because the costs were "incurred prior to the effective date of the Notice of Award[,] and [p]rior approval was not requested and approved for these pre-award costs." *Id.* at 3. DFI further found that MCHC should return \$69,015 "for construction work . . . using force account labor." *Id.* The report stated that section 74.43 "provides that all procurement transactions must be conducted in a manner providing full and open competition." *Id.* "Within the context of construction development," the report provided, "this ordinarily means solicitation and obtaining of competitive bids." Because MCHC did not demonstrate that it awarded the construction work "through open and free competition," DFI concluded, \$69,015 "has been disallowed." *Id.*

HRSA subsequently performed an additional review and notified MCHC in a March 16, 2016 letter that it had determined that MCHC charged \$109,212 in unallowable costs to the award. HRSA Ex. 4. HRSA stated that MCHC provided a July 17, 2015 response to the DFI report in which MCHC "addressed three selected unallowable costs totaling \$163,164.35" but did not address the remaining \$5,197 in costs that the DFI concluded were not allowable. *Id.* at 2. Based on MCHC's response, HRSA determined, \$59,149 of the questioned costs (for HVAC installation) were allowable. HRSA further determined that \$35,000 incurred for paving prior to the start of the project period was unallowable because MCHC had not requested and received prior approval for these costs. HRSA also concluded that MCHC "did not obtain prior approval for force labor

costs of \$69,015.09, as required by 45 CFR §74.25[, and] ... did not solicit competitive bids, required by 45 CFR §74.43, for the force account labor costs.” *Id.* The disallowed \$109,212 is the sum of the unaddressed costs, the unapproved paving costs and the unapproved force account labor costs.

MCHC timely appealed the disallowance to the Board pursuant to 45 C.F.R. Part 16. The Board’s acknowledgment of MCHC’s appeal invited the parties to comment in their briefs on the relevance of the following Board decisions: *Community Medical & Dental Care, Inc.*, DAB No. 2556, at 10-13 (2014) (addressing the use of a force account); and *William Smith, Sr. Tri-County Child Dev. Council, Inc.*, DAB No. 2647, at 5-7 (2015) (addressing pre-award costs).

II. Analysis

A. *We sustain the disallowance of \$69,015 for in-house staff labor costs.*

Federal regulations and the GPS, applicable under the terms of MCHC’s award, required MCHC to solicit bids for grant-funded construction activities and limited MCHC’s use of in-house staff for renovations. Section 74.43 of the regulations, “Competition,” provides in part that “[a]ll procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.” Under the regulation, “Awards shall be made to the bidder or offeror whose bid or offer is responsive to the solicitation and is most advantageous to the recipient, price, quality and other factors considered.” The implementing GPS Procurement Requirements provide, “Construction activity usually is carried out through one or more contracts under the grant All construction work must be procured by the methods described in 45 CFR 74.40 through 74.48” GPS II-102.

The section on Construction and Modernization of Facilities in the GPS specifies that a grantee may forego the competitive bidding process and use in-house staff for renovations in the following limited circumstances:

If the grantee’s own construction and maintenance staffs are used in carrying out modernization activities (i.e., force account), the associated costs are allowable provided the grantee can document that a force account is less expensive than if the project were competitively bid and can substantiate all costs with appropriate receipts for the purchase of materials and certified pay records for the labor involved. This requires OPDIV prior approval.

GPS at II-100. As used in the GPS, the term “modernization” includes alteration and renovation. *Id.* at II-98.

In *Community Medical & Dental Care*, the Board addressed this section of the GPS, the grantee's CIP award application, and records submitted on appeal in determining that in-house employee salaries and fringe benefits costs were unallowable because the grantee did not have prior approval by the HRSA GMO "to use in-house labor for the project and, in any event, did not adequately document the costs of the in-house labor." DAB No. 2556, at 10-14.

Here, MCHC acknowledges the prior approval requirement, but states that "due to [its] inexperience with this type of grant reporting, [it] inadvertently did not follow the prescribed procedure for requesting approval for force-account labor." MCHC Br. at 1. MCHC further states, however, that it "demonstrate[d] cost-effectiveness in completing [its] projects by utilizing existing MCHC facilities and maintenance staff where possible, in order to allow for more improvements to be completed in the specialty areas, such as window replacement, roofing and pavement, where outside contractors were hired with appropriate bidding practices." *Id.* MCHC states that it has since "gained experience with subsequent like-type awards, and is fully aware of the prior approval process and has successfully submitted these requests with no issues." *Id.* MCHC asks that the charges be allowed based on the "documentation initially submitted and the quarterly reporting that took place during this period." *Id.*

In reviewing HRSA's disallowance, the Board is "bound by all applicable laws and regulations." 45 C.F.R. § 16.14. The Board is empowered to resolve legal and factual disputes and has no authority to waive a disallowance. *Arlington Cmty. Action Program, Inc.*, DAB No. 2141, at 5 (2008); *Bedford Stuyvesant Restoration Corp.*, DAB No. 1404, at 20 (1993). The Board therefore must uphold a disallowance where, as in this case, the disallowance "is authorized by law and the grantee has not disproved the factual basis for the disallowance." *S.A.G.E. Commc'ns Servs.*, DAB No. 2481, at 5-6 (2012) (citations omitted). MCHC concedes that it did not engage in competitive bidding for the force account costs or obtain HRSA's prior approval to use force account labor for the renovations. Accordingly, we sustain the disallowance of \$69,015 in force account labor costs. We note that even if the Board could waive the prior approval requirement (which it cannot), MCHC has not provided documentation showing that its use of in-house labor was less expensive than if the work were competitively bid or substantiating all costs with appropriate receipts for the purchase of materials and certified pay records.

B. We sustain the disallowance of \$35,000 for paving costs.

The Board explained in *William Smith, Sr. Tri-County Child Development Council*, “[s]ection 74.28 of the uniform administration requirements states that when an award specifies a funding period, ‘a [grantee] may charge to the award only allowable costs resulting from obligations incurred during the funding period’” DAB No. 2647, at 5, citing 45 C.F.R. § 74.28.⁵ “That prohibition flows from the requirement in OMB Circular A-122 that a grantee’s costs be ‘allocable to’ the federal award,” that is, “of benefit to the activities for which the grant was awarded.” *Id.*; *River East Economic Revitalization Corp.*, DAB No. 2087, at 6 (2007) (citations omitted). “The term ‘benefit,’ as used in connection with the concept of allocability, derives from accounting principles that the costs must relate not only to cost objectives, but to funding periods as well.” *Delta Found., Inc.*, DAB No. 1710, at 37 (1999), *aff’d*, *Delta Found., Inc., v. Thompson*, 303 F.3d 551 (5th Cir. 2002). “The fact that expenditures are incurred outside” of a grant period “necessarily means that they are not allocable to the grant[] and is a sufficient basis in itself for a disallowance.” *Id.*, citing DAB No. 1404, at 15. Consequently, a grantee that wishes to charge pre-award costs to a federal award must obtain the permission of the awarding agency, which is authorized to grant waivers permitting recipients to charge pre-award costs to federal awards. 45 C.F.R. §§ 74.28, 74.25(d)(1); *see also* OMB Circular A-122, Att. B, ¶ 36 (pre-award costs allowable “only with the written approval of the awarding agency”).

As set forth above, MCHC’s grant project and budget period began on June 29, 2009. MCHC’s CIP award notice specified that “HRSA is permitting a grantee to incur pre-award costs up to 90 calendar days prior to the award of a Federal grant with the prior approval of the HRSA Grants Management Officer.” HRSA Ex. 1, at 7-8. The award notice further stated: “Items that require prior approval from the awarding office as indicated in 45 CFR Part 74.25 . . . must be submitted in writing to the Grants Management Officer (GMO). Only responses to prior approval requests signed by the GMO are considered valid.” *Id.* at 17.

MCHC has provided a copy of a proposal by E. Sprague Paving Inc. to repave and repair the parking lot for MCHC’s Benton Avenue project for \$24,000. The proposal is dated April 4, 2009, and signed as accepted by MCHC on May 5, 2009. MCHC Ex. 2, at 1.

⁵ The Board noted that the term “funding period” is defined in the Part 74 regulations to mean “the period of time when Federal funding is available for obligation by the recipient,” and the term “obligations” is defined in Part 74 as “the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the [grantee] during the same or a future period.” 45 C.F.R. § 74.2. DAB No. 2647, at 5 nn.7, 8.

The terms of the proposal provide, “10% Deposit Required – Balance on completion of job.” *Id.* MCHC states, and provides a ledger report showing, that it made payments of \$2,400 on May 6, 2009, and \$21,600 on May 22, 2009 for the Benton Avenue work. MCHC Br. at 1; MCHC Ex. 2, at 2.

The Benton Avenue paving documentation thus shows that \$24,000 in paving costs were incurred and paid before the grant period began on June 29, 2009. While MCHC incurred and paid the costs within the 90-day period before the grant period began, it admittedly did not submit a request to the HRSA GMO to charge the costs to its CIP award. MCHC Br. at 1. Accordingly, we sustain HRSA’s disallowance for these paving costs.

MCHC also provided a copy of a proposal by E. Sprague Paving Inc. to repave and repair the parking lot for MCHC’s Orchard Street project for \$11,000. MCHC Ex. 2, at 3. The proposal is dated April 6, 2009, and its terms provide, “10% Deposit Required – Balance on completion of job.” *Id.* Although the document includes an authorized signature indicating that MCHC accepted the proposal, the acceptance is undated, and MCHC has not made any representation about when it accepted the proposal. *Id.* In its April 13, 2016 notice of appeal, MCHC states, “the final check for payment was not cut until August 5, 2009 and the work was not completed until a few days after that.” Notice of Appeal at 1. MCHC submitted a ledger report showing that a payment of \$11,000 was made to the contractor for the Orchard Street paving project on August 5, 2009, but MCHC has not provided any documentation to show that work was actually performed “a few days after that” or at any time during the project period. MCHC Ex. 2, at 4. In its brief, MCHC asserts that “[a]lthough the work was started pre-award, the period of time is within 60 days, and payment was made post-award.” MCHC Br. at 2.

The Board previously has held that contracted services performed prior to the beginning of an ARRA CIP grant period for which the grantee made payment during the grant period “were pre-award costs because the funds were obligated when the work was performed, if not earlier.” *Dr. Arenia C. Mallory Cmty. Health Ctr., Inc.*, DAB No. 2659, at 12 (2015). Here, MCHC paid for the Orchard Street project paving costs during the grant period, but the record does not show when the costs were incurred, and, as noted above, MCHC admits that the work “was started pre-award.” Moreover, although MCHC initially alleged on appeal that some of the paving work was performed during the grant period, Notice of Appeal at 1, it did not provide any documentation to support this assertion. The fact that MCHC’s ledger shows that MCHC paid for the Orchard Street project costs in August 2009 alone is not sufficient to establish that the paving work was performed around or at that time. As stated above, 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. Accordingly, absent documentation establishing that the Orchard Street paving work was performed during the grant period or that MCHC obtained prior approval by HRSA to charge these costs to the CIP award, we must sustain HRSA's disallowance of the Orchard Street project paving costs.

III. Conclusion

For the reasons stated above, we sustain the disallowance of \$109,212.

/s/
Constance B. Tobias

/s/
Susan S. Yim

/s/
Sheila Ann Hegy
Presiding Board Member