

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

Kids Central, Inc.  
Docket No. A-18-38  
Decision No. 2897  
September 20, 2018

**DECISION**

Kids Central, Inc. (KCI) appeals the January 19, 2018 decision of the Administration for Children and Families (ACF) disallowing \$56,393 in federal funding provided to KCI for its Head Start and Early Head Start programs for KCI's fiscal year (FY) ending May 31, 2015 (June 1, 2014 - May 31, 2015). ACF determined that the amount of \$56,393 that KCI paid to its employees as incentive compensation did not comport with applicable cost principles. For the reasons discussed below, we uphold the disallowance in full.

**Legal background**

The Head Start program, authorized under the Head Start Act, 42 U.S.C. § 9801 *et seq.*, as amended, provides comprehensive early child education, nutrition, and health services to low-income children and their families. Non-profit organizations that receive federal grants, including Head Start grants, are subject to the cost principles in Office of Management and Budget (OMB) Circular A-122, "Cost Principles for Non-Profit Organizations"<sup>1</sup> and to the uniform grant administrative requirements at 45 C.F.R. Part 74, currently codified in 45 C.F.R. Part 75.<sup>2</sup> 45 C.F.R. §§ 74.1(a)(1), 74.27, 1301.10.<sup>3</sup>

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<sup>1</sup> OMB Circular A-122 was previously codified in Appendices to 2 C.F.R. Part 230. *See* 70 Fed. Reg. 51,927 (Aug. 31, 2005); 2 C.F.R. Part 230 (Jan. 1, 2013). In December 2013, OMB consolidated the content of OMB Circular A-122 and other OMB circulars into a streamlined set of uniform administrative requirements, cost 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).

<sup>2</sup> Effective December 26, 2014, the "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards" published in 45 C.F.R. Part 75 superseded Part 74 of Title 45 of the Code of Federal Regulations. *See* 79 Fed. Reg. 75,872, 75,875-876 (Dec. 19, 2014). We cite to the Part 74 regulations, which were in effect at the time the grant at issue was awarded and throughout the time when KCI incurred the costs at issue. There are no substantive material differences between the Part 74 and Part 75 regulations that affect our analysis here.

<sup>3</sup> The performance standards for Head Start programs in 45 C.F.R. Parts 1301-1310 were revised effective November 7, 2016, after the time period at issue here. 81 Fed. Reg. 61,294 (Sept. 6, 2016). We rely on the pre-revision standards.

A cost is allowable under a federal award if, among other things, it is adequately documented, reasonable for the performance of the award, and allocable thereto. 2 C.F.R. Part 230, App. A ¶ A.2.a, g. Costs are reasonable if they “do[ ] not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs.” *Id.* ¶ A.3. Costs are allocable “to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received.” *Id.* ¶ A.4.a.

The cost principles also address the allowability of specific items of cost, including “[c]ompensation for personal services,” which is defined in relevant part to include “all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award . . . .” *Id.* App. B ¶ 8. Such compensation includes “incentive awards” and “incentive pay.” *Id.* Specifically, with respect to incentive compensation, the cost principles state:

Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

*Id.* ¶ 8.j.

In accordance with the grant administrative requirements in the Part 74 regulations, a Head Start grantee receives discrete annual federal “awards,” with each award corresponding to a specific “funding period” (or budget period). *Teaching & Mentoring Communities, Inc.*, DAB No. 2790, at 9 (2017). A “[f]unding period” is the “period of time when Federal funding” under an award “is available for obligation by the [award] recipient.” 45 C.F.R. § 74.2 (also defining “[a]ward”). The term “[o]bligations” means “the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period.” *Id.* And, as relevant here, “[w]here a funding period is specified, a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period.” *Id.* § 74.28. An award recipient also must have in place a financial management system that provides “[r]ecords that identify adequately the source and application of funds for HHS-sponsored activities” and “[e]ffective control over and accountability for all funds, property and other assets.” *Id.* § 74.21(b)(2), (3). A recipient “shall adequately safeguard all such assets and assure that they are used solely for authorized purposes.” *Id.* § 74.21(b)(3).

A Head Start grantee is also subject to governance requirements. The grantee must have a “governing body” that holds legal and fiscal responsibility for the grantee, 42 U.S.C. § 9837(c)(1)(A), and whose members possess background and expertise in certain areas (such as early childhood education and development; fiscal management; or accounting). *Id.* § 9837(c)(1)(B). The governing body is responsible for, among other things, “reviewing and approving” all major policies of the grantee, including personnel policies concerning the compensation of grantee employees. *Id.* § 9837(c)(1)(E)(iv). A Head Start grantee also must also have a “policy council,” which is responsible for the direction of the Head Start program, including its program design and operations. *Id.* § 9837(c)(2)(A). Policy council members are elected by the parents of children currently enrolled in the grantee’s program and are either parents of current or former enrollees or other community members. *Id.* § 9837(c)(2)(B). The policy council’s functions include establishing and implementing “written personnel policies for staff” (45 C.F.R. § 1301.31(a)) and “work[ing] in partnership with key management staff and the governing body to develop, review, and approve or disapprove . . . [p]rogram personnel policies and subsequent changes to those policies, in accordance with 45 CFR 1301.31, including standards of conduct for program staff, consultants, and volunteers” (*id.* § 1304.50(d)(1)(ix)).

Under the “applicable regulations and cost principles, a grantee bears the burden of documenting the existence and allowability of its expenditures of federal funds.” *Touch of Love Ministries, Inc.*, DAB No. 2393, at 3 (2011). If a grantee “materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute or regulation, an assurance, an application, or a notice of award,” the awarding agency may “[d]isallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance.” 45 C.F.R. § 74.62(a)(2); *see also Bright Beginnings for Kittitas Cnty.*, DAB No. 2623, at 2 (2015) (citing 45 C.F.R. § 1301.10(a) and stating that compliance with Part 74 requirements is a term and condition of a Head Start grant); *Tex. Migrant Council*, DAB No. 842 (1987) (sustaining a disallowance based on a violation of federal cost principles); *Greater Phila. Health Action, Inc.*, DAB No. 1605 (1996) (upholding a disallowance of costs that were not “reasonable” under the cost principles).

## **Case background**

KCI, a non-profit organization, provides Head Start and Early Head Start services in southwestern Virginia. KCI Br. at 1; KCI Ex. 2, at 3. On November 14, 2014, KCI paid its employees a total of \$56,393 in incentive compensation (KCI Exs. 14, at 3-4; 15, at 6) in accordance with its Employee Incentive Policy, which states as follows:

## Employee Incentive

Kids Central recognizes that the children and families we serve are what continue to make this Agency succeed. We also recognize that it takes a diligent effort by all staff to ensure we continually meet our enrollment obligations. Kids Central will offer incentives to full-time employees and regular part-time employees, when our enrollment is maintained based on the procedures below. All other regular part-time employees will receive a minimum of \$25.00 or \$10.00 per year of service for a maximum amount of \$100.00 based on the procedure below. This is awarded to show our appreciation for the continuous hard work of our employees.

### PROCEDURE

1. Enrollment must be at its capacity for a one-year period (November 1 thru October 31).
2. Current employees employed one year or more, based on anniversary date, will be eligible for an incentive up to 3% of their annual salary.
3. Incentives will be awarded as long as funds are available.
4. Incentives will be awarded to employees by December 15<sup>th</sup>.
5. Kids Central's Senior Management Team and the Board of Directors will be responsible for verifying enrollment and approving the employee incentive each year.
6. Employees should realize this is not a guarantee of a yearly employee incentive.

KCI Ex. 6, page 5.<sup>4</sup>

In early April 2015, ACF conducted a "Fiscal/ERSEA" (Eligibility, Recruitment, Selection, Enrollment, and Attendance) review of KCI's Head Start and Early Head Start programs. KCI Ex. 15, at 1. In an "Overview of Findings" report dated August 14, 2015, ACF stated that KCI was "out of compliance with one or more applicable Head Start Program Performance Standards, laws, regulations, and policy requirements." *Id.* As relevant here, ACF found that KCI "made incentive payments [totaling \$56,392.90] not

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<sup>4</sup> KCI's exhibit 6 comprises five pages, the first four of which are paginated; the fifth is not. The incentive compensation policy, which KCI submitted as page five of its exhibit 6, is not dated. However, the first four pages of exhibit 6 are the April 16, 2013 KCI Board of Directors meeting minutes. Evidently, in 2008, KCI put in place an incentive policy, the terms of which were similar to that submitted as part of KCI's exhibit 6, but which provided for an incentive of "up to 1.5%" (rather than "up to 3%") of an employee's annual salary. KCI Ex. 3, at 2. KCI eliminated its incentive policy in March 2015. KCI Br. at 6; KCI Ex. 13 ("Incentive Pay Removed from Program March 2015").

based on valid incentive criteria” and did not “adhere to its written [incentive] plan criteria” as to those incentive payments during FY 2015, as KCI was required to do in accordance with 2 C.F.R. Part 230 (OMB Circular A-122), Appendix B, ¶ 8.j. *Id.* at 5-6. ACF stated:

The grantee compensated employees based on full enrollment and years of service in excess of 1 year.

In an interview, the Comptroller stated the grantee had an incentive plan based on attaining full enrollment, and upon reaching its goal, the grantee awarded every employee employed longer than 1 year incentive compensation. A review of the employee handbook confirmed these statements. The Human Resources Manager confirmed all eligible employees were included in the \$56,392.90 in incentives paid November 14, 2014.

Full enrollment was not an allowable criterion for use in satisfying incentive compensation requirements. In addition, an interview with the Assistant Director of Child Services and a review of documents in the Head Start Enterprise System determined the grantee did not achieve full enrollment for October 2014.

*Id.* at 6. An independent auditor of KCI’s financial statements similarly determined that the payments were “not based on valid criteria” and that KCI did not “adhere to its written plan criteria.”<sup>5</sup> ACF Ex. 4<sup>6</sup> (December 2015 audit report), at 22.

Following a March 2016 monitoring review, ACF issued on September 15, 2016, an “Overview of Findings” report. ACF Ex. 3. Therein ACF stated:

A review of the Revision of Pay Scale document approved by the Board [of Directors] and the Policy Council in March 2015 found the grantee no longer provided incentive payments to staff for achieving full enrollment. The document stated the elimination of incentive awards was necessary to restructure the base pay scale for all grant employees. As a result of the grantee’s decision, staff were directed to revise the policies and procedures to reflect the elimination of incentive compensation.

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<sup>5</sup> Under the Single Audit Act, 31 U.S.C. § 7501 *et seq.*, as amended, a non-profit organization-grantee, such as KCI, whose expenditures of federal funds in any fiscal year exceeds a certain threshold amount must undergo an annual financial and compliance audit in accordance with OMB Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations.” *See* 31 U.S.C. § 7502(a)(1)(A); 45 C.F.R. § 74.26(a).

<sup>6</sup> ACF marked its six exhibits as “CMS” exhibits (e.g., “CMS Ex. 1”). We refer to ACF’s exhibits using “ACF Ex.” followed by the exhibit number and the page number(s).

In interviews, the Board [of Directors] and Policy Council Chairs stated both bodies approved the elimination of incentive compensation from the personnel policies. In a written statement, the current Comptroller – hired in October 2015 – stated she did not receive specific training on the Incentive Compensation plan since it was eliminated prior to her tenure.

The elimination of incentive programs from the grantee’s Human Resource Policies and Procedures provided assurance similar, unallowable payments would not be made in the future; however, the grantee did not provide documentation to show the November 14, 2014 \$56,393 incentive payments to staff was reimbursed to HHS. . . . The unresolved amount identified as a potential disallowance will be referred to [ACF] for resolution.

*Id.* at 6.

By decision dated January 19, 2018, ACF notified KCI that ACF was disallowing \$56,393. KCI Ex. 16, at 1-3 (citing OMB Circular A-122). KCI appealed the disallowance to the Board.

## **Analysis**

### *A. KCI improperly spent \$56,393 for the 2014-2015 funding period for an obligation incurred in 2013.*

We first address a basic issue raised in this case, i.e., whether the disallowed amount represents the use of funds for an obligation incurred during the period from June 2014 through May 2015, which ACF states, and KCI does not dispute, is the funding period (or budget period) at issue. In its response brief, ACF asserts that KCI improperly used funds for the 2014-2015 funding period for 2013 expenses. ACF Response at 2, 3, 7-8, 14. KCI has not responded to this argument.<sup>7</sup>

In accordance with KCI’s incentive compensation policy, employees were to be paid incentives by December 15 of the year if KCI attained full enrollment during the incentive period designated as the period from November 1 of the prior year through October 31 of the year payment was to be made. KCI Exs. 4; 6, page 5. KCI does not dispute that it paid \$56,393 in incentive compensation on November 14, 2014 as the August 14, 2015 “Overview of Findings” report indicates (KCI Ex. 15, at 6), and that this

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<sup>7</sup> KCI filed its Notice of Appeal and brief in support of its appeal (with exhibits), but did not avail itself of the opportunity to respond to certain arguments made by ACF in its response brief by filing a reply brief and/or any additional exhibits. Accordingly, those arguments remain un rebutted.

payment date fell within the funding period, June 2014-May 2015. However, KCI informs the Board that it paid the incentive compensation in November 2014 only because it was unable to pay it on or before December 15, 2013 for the November 1, 2012-October 31, 2013 incentive period – during which KCI reportedly achieved the policy’s stated objective to achieve full enrollment – due to the federal sequestration of fiscal year 2013 Head Start funding, to which KCI responded by cutting its budget from which it had intended to pay the 3% incentive compensation.

KCI states:

Notwithstanding the valiant efforts of KCI’s staff and the fact that KCI was at full enrollment for the period November 1, 2012 to October 31, 2013, funds for the incentive payment earned for this period had been sequestered. . . . KCI was forced to make reductions in its budget during the 2013-2014 fiscal year as a result of the impacts of sequestration on all Head Start programs. . . . Therefore, the incentive compensation could not be paid to staff.

KCI Br. at 4 (citations to the record omitted). KCI also states:

When funds became available in next fiscal year [2014] the Board [of Directors] made the decision to “catch up” on the incentive payment. . . . This payment was not for attendance [i.e., full enrollment] occurring in fiscal year 2014-2015[.]

Notice of Appeal at 2; *see also* KCI Ex. 8 (ACF’s Program Instruction issued April 26, 2013, stating that final FY 2013 Head Start funding will be reduced by 5.27% until Congress takes action on a FY 2014 budget) and KCI Ex. 13 (KCI’s enrollment statistics, indicating “Incentive NOT PAID” for November 2012-October 2013 “due to Federal Sequestration of Funds”).

KCI effectively acknowledged that it paid \$56,393 in incentives in November 2014 for achieving full enrollment during a prior incentive period (November 2012-October 2013) rather than the November 2013-October 2014 incentive period. In so doing, KCI used funding for the June 2014-May 2015 funding period to pay for incentive compensation costs that were obligated or incurred earlier, for the November 2012-October 2013 incentive period, and payable by December 15, 2013. KCI’s use of the funds therefore was not consistent with 45 C.F.R. § 74.28, which provides that “a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period.”

The Board has long upheld ACF disallowances based on Head Start grantees' noncompliance with 45 C.F.R. § 74.28 by using funds awarded for one funding period to pay for costs incurred during another. *See, e.g., Teaching & Mentoring Communities* at 10 (“[G]rant funds earmarked for one funding period may not be used to pay costs incurred outside that period.”); *Council for the Spanish Speaking, Inc.*, DAB No. 2718, at 6 (2016) (The limitation in section 74.28 “reflects the general requirement in OMB Circular A-122 that allowable costs charged to a federal award must be allowable to the award.”); *Cent. Piedmont Action Council, Inc.*, DAB No. 1916, at 3 (2004) (“[G]rant funds awarded for one funding period [must] be used to pay for expenses from that year only, and not for any other program year.”).

We conclude that KCI spent funds in one funding period to pay for costs incurred in the prior funding period. As explained further below, KCI demonstrated no prior approval or other basis to show that this expenditure was permissible.

*B. The sequestration provides no basis for reversing the disallowance, and KCI has not shown that it specifically requested supplemental funding to pay for the incentives as it could have done after the sequestration was lifted.*

KCI strongly implies that, but for the sequestration, there would be no basis for the disallowance. KCI Br. at 4 (KCI was “forced” to reduce its FY 2013-2014 budget “as a result of the impacts of sequestration.”), 5 (No compensation was paid for the November 2012-October 2013 period “as a result of sequestration.”), 14 (“The facts and circumstances which preceded the disallowance . . . by and large are attributable to the constraints and confusion created by sequestration.”). In essence, KCI relies on the sequestration and subsequent restoration of funding to justify spending FY 2014-2015 funds on this cost which it was unable to cover from its FY 2013-2014 period funds. But the sequestration had a program-wide effect (though temporary) on Head Start funding. It was KCI’s decision to cut incentives in the immediate term in response to the sequestration in view of its own budget constraints. Moreover, KCI has not specifically explained what it means by “constraints and confusion created by sequestration.”

KCI has, however, submitted ACF’s Program Instruction ACF-PI-HS-14-01, issued February 10, 2014, announcing the restoration of 5.27% funding reduction in fiscal year 2013 due to sequestration (2014 Program Instruction) and informing grantees whose funding was affected by the sequestration of their eligibility to receive supplemental awards upon application. KCI Ex. 10. Relying on the 2014 Program Instruction, which stated, in part, that ACF expects Head Start grantees affected by the sequestration to “use [the supplemental awards] to restore the number of funded enrollment slots, the number of days or weeks in the program year, or the other cuts programs made to absorb the reduction” (KCI Br. at 5 (quoting KCI Ex. 10, at 2) (internal quotation marks omitted)),



KCI maintains that, in response to the 2014 Program Instruction, it submitted to ACF an application for a supplemental award, dated April 29, 2014, that KCI says “include[d] the pay incentive of 3.0 % to all qualifying employees for maintaining full enrollment,” was approved by KCI’s Board of Directors, and complied with all Head Start requirements. Notice of Appeal at 2; KCI Br. at 5 (stating that its April 2014 “refunding application states that incentive pay of 3% will be reinstated” and that the “application was then approved by the Office of Head Start”). KCI also states that it had understood the 2014 Program Instruction to mean that “restored funding was to be used to reinstate budget cuts which were made as a result of sequestration, which included incentive compensation payments.” KCI Br. at 17. Also, citing *Home Education Livelihood Program, Inc.*, DAB No. 1598 (1996), KCI states that therein the Board “reversed an ACF decision where an agency [i.e., grantee] had in good faith attempted to comply with the regulations” where “the local [H]ead [S]tart agency had conducted its program based on its interpretation of regulations as to whether staff was required to undergo health examinations.”<sup>8</sup> *Id.* at 16-17.

We understand KCI’s statements and its reliance on *Home Education* to mean that KCI is asserting that it reasonably interpreted ACF’s 2014 Program Instruction concerning how a request for supplemental award was to be made and complied with the 2014 Program Instruction, and took ACF’s approval of KCI’s April 2014 application to mean that ACF had approved the incentive compensation costs. The 2014 Program Instruction announced that Head Start grantees affected by the sequestration were eligible for supplemental funding to restore the sequestered funds, but specifically stated that affected grantees were “required to request these funds through a grant application.” KCI Ex. 10, at 1. In April 2014, KCI did file such an application, stating that “we will . . . add back the 3% incentive payment to our staff that we pay based on our program being fully enrolled.” KCI Ex. 11, at 1.

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<sup>8</sup> *Home Education* involved ACF’s disallowance of Migrant Head Start funding for numerous alleged improper expenditures of federal funding, as well as ACF’s determination to terminate Home Education’s Migrant Head Start grant based on alleged failure to meet numerous program requirements. The Board upheld a part of the disallowed amount and concluded that the few program deficiency findings the Board was sustaining were not shown to have been material deficiencies to support termination of the grant (DAB No. 1598, at 1-3, 100), the rationale for which was not limited to analysis of the issue of whether Home Education complied with a regulation requiring that grantee staff undergo health examinations to ensure that they do not have communicable diseases (*id.* at 87-89). On that question, the Board noted that there were “at least two conflicting interpretations of the regulation even within ACF” and that it was “reasonable that [Home Education], which runs two Head Start programs, one governed by [ACF’s] central office and one by [ACF’s] Region VI office, relied on the interpretation of the Region VI office where ACF has offered no evidence that there was ever any specific intent or policy reason to treat the Migrant and Regional programs differently . . .” *Id.* at 88. The Board moreover stated that evidence that Home Education took certain action, though after the relevant time period, in accord with the central office’s interpretation of the regulation once Home Education became aware of that interpretation, was “indicative of [Home Education’s] good faith attempt to comply with” the regulation. *Id.* By Ruling dated January 8, 1997, the Board denied ACF’s request for reconsideration of DAB No. 1598.

ACF, however, maintains that the “critical document” is KCI’s April 2014 funding application. ACF Response at 14. As ACF says, in that application KCI could have asked for ACF approval of supplemental funding specifically to restore KCI to the funding level prior to the sequestration, but did not specifically ask for such funding. According to ACF, the application form included a separate section where grantees could request funds to pay for 2013-2014 program year expenses, but KCI did not specifically request any increase for the June 2013-May 2014 period; KCI requested an increase only for the June 2014-May 2015 period. *Id.* at 8-10, 14; KCI Ex. 11, at 1-2. Accordingly, says ACF, although ACF approved KCI’s application, ACF did not specifically approve funding to pay for the incentive compensation that KCI admits had been incurred by the end of October 2013 and due to be paid by December 15, 2013. ACF Response at 9-10.

KCI has had an opportunity to respond to this specific argument by ACF in its response brief based on the specific contents of KCI’s application – which is of record before the Board because KCI submitted it as an exhibit to its opening brief – but has not done so and it thus remains unrebutted. KCI has not actually pointed to anything specific in the 2014 Program Instruction or the funding application form that could have been subject to more than one reasonable interpretation on which we could now determine KCI reasonably relied. For these reasons, *Home Education* does not support KCI’s position. Moreover, having carefully considered the 2014 Program Instruction, we see nothing in it suggesting that any supplemental award to be made may be used to pay for expenses that were incurred or would have been incurred but for the sequestration. Nor does the 2014 Program Instruction state, let alone suggest, that a supplemental award may be used to pay for incentive compensation that a grantee could have or would have paid for a prior year but for the sequestration. Lastly on this issue, we comment that merely stating in the application for a supplemental award that KCI intended to use the award to “add back the 3% incentive payment . . . based on [its] program being fully enrolled” (KCI Ex. 11, at 1) does not specifically convey that KCI intended to use the award to make *retroactive* incentive payments for achieving full enrollment in a *prior funding period*. Accordingly, ACF’s approval of the supplemental award based on KCI’s April 2014 application may not reasonably be viewed as to imply ACF approval of the retroactive incentive payments.

We conclude that neither the ACF 2014 Program Instruction nor the approval of KCI’s application gave KCI any basis to charge to its 2014-2015 incentive payments due in December 2013 and tied to prior year enrollment figures.

*C. KCI has not shown that the 2013 incentive policy under which KCI paid \$56,393 was approved by KCI's Board of Directors and Policy Council as required.*

As discussed earlier, a Head Start grantee's governing body must approve its personnel policies concerning the compensation of its employees. 42 U.S.C. § 9837(c)(1)(E)(iv). Its policy council must establish, approve and implement personnel policies and changes to those policies. 45 C.F.R. §§ 1301.31(a), 1304.50(d)(1)(ix).

KCI put in place an incentive compensation policy in 2008. KCI Exs. 3, at 2 and 4. That policy stated, in part, that "[c]urrent employees employed one year or more, beginning November 1 thru October 31, will be eligible for an incentive up to 1.5% of their annual salary." KCI Ex. 4. The minutes for the February 19, 2008, KCI Board of Directors meeting state that R.M., an individual identified in the meeting minutes as a member of the Board of Directors, made the motion to approve the 1.5% incentive compensation policy; that C.M., another member of the Board of Directors, "seconded" the motion; that the motion was "carried"; and that KCI's "management team will be responsible for the process of this policy." KCI Ex. 3, at 2. Similarly, the minutes for the February 13, 2008 KCI Policy Council meeting reflects that the Policy Council approved the 1.5% incentive compensation policy. ACF Ex. 6, at 1, 2, 5. We accept KCI's exhibit 3 and ACF's exhibit 6 as evidence that KCI's governing body (Board of Directors) and Policy Council approved an incentive compensation policy in 2008 (KCI Ex. 4). However, the disallowed amount admittedly represents incentive compensation paid in November 2014 in accordance with the policy to pay up to 3% of employee salary (KCI Br. at 3, 13), years after the 2008 policy was put in place. This raises a question as to whether the "up to 3%" policy – which represents a material change to the 2008 policy – underwent required approval by the Board of Directors and Policy Council as the 2008 "up to 1.5%" policy had.

KCI states that, "[i]n 2013, the plan was amended to offer applicable employees additional compensation of 3% of his or her salary."<sup>9</sup> KCI Br. at 3. KCI relies on the April 16, 2013, KCI Board of Directors meeting minutes – and only on those minutes – as evidence of amendment. KCI Br. at 3, 13; KCI Ex. 6.<sup>10</sup> But those minutes refer, without specificity, to Board of Directors' approval of proposed changes to KCI's employee policy manual. KCI Ex. 6, at 2. As discussed earlier, the "up to 3%" incentive compensation policy itself was submitted as the last page (page 5) of KCI's exhibit 6,

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<sup>9</sup> KCI has not stated to the Board that its incentive compensation policy is not a personnel policy subject to approval by its Board of Directors and Policy Council, or that an amendment to its 2008 policy to pay an increased 3% incentive is not subject to approval by both bodies. As we have indicated elsewhere, KCI has not filed a reply brief responding to ACF's arguments in its response brief concerning required approval of the policy.

<sup>10</sup> KCI refers to its exhibit 5. KCI Br. at 3, 13. We assume it intended to rely on the April 16, 2013 Board of Directors meeting minutes, of record as KCI exhibit 6.

presumably as support that the policy was the subject of the Board of Directors' discussion on April 16, 2013. The meeting minutes do not address anything about an amendment to an incentive compensation policy, let alone Board of Directors approval of an amendment to such a policy. We will not simply infer that the Board of Directors specifically approved what represented a material change to KCI's incentive compensation policy based only on a general reference to approval of changes to KCI's employee policy manual in the April 16, 2013 Board of Directors meeting minutes. Nor has KCI offered anything indicating that its Policy Council approved the amendment to the incentive compensation policy ("up to 3%") as it had with respect to the 2008 incentive compensation policy ("up to 1.5%"). ACF Ex. 6.

*D. KCI did not adhere to its incentive compensation policy.*

As set out above, the incentive compensation at issue is not allowable because (1) KCI used funds for one budget period to pay for costs incurred during another, earlier period; and (2) KCI paid the incentive compensation under a policy that is not shown to have been approved by its Board of Directors and Policy Council, as required. We have also rejected KCI's arguments concerning the sequestration. We note, furthermore, that even were we to assume that KCI used the funds as they were incurred within the funding period and that it paid incentive compensation in accordance with a policy in place at the time the compensation was paid, the payments still would not be allowable for other reasons.

The incentive compensation policy purportedly approved in 2013 states: "Enrollment must be at its capacity for a one-year period (November 1 thru October 31)." KCI Ex. 6, page 5. KCI alleges that it met its stated "full enrollment" goal for the November 2012-October 2013 incentive period for which it paid the incentive compensation in November 2014 (rather than by December 15, 2013) due to the sequestration (KCI Br. at 4, 5, 15), as well as for the subsequent November 2013-October 2014 incentive period (for which payment was due December 15, 2014), *id.* at 17. KCI also states that in furtherance of its "full enrollment" goal, its staff members "who range from cooks and caregivers up to key administrators" have "share[d] with friends, family, neighbors, fellow parishioners, and strangers encountered on the street the opportunities KCI offers to disadvantaged children." *Id.* at 3. KCI employees reportedly "have approached people . . . [who] were with enrollment aged children and handed out brochures, posted flyers in public places as well as on social media, provided applications, and even assisted with the completion of applications." *Id.*

But KCI's own evidence – its enrollment statistics for the November 2013-October 2014 period – indicates that full enrollment was not achieved for that period, but that KCI nevertheless paid incentive compensation in November 2014. KCI Ex. 13 (indicating "NO" for "Fully Enrolled" in October 2014, but also indicating "Incentive Paid after 23

months of Full Enrollment,” i.e., referring to November 2012 through September 2014, not including October 2014).<sup>11</sup> Thus, KCI did not adhere to its own policy terms to pay incentives by December 15 based on full enrollment achieved during the 12-month incentive period that ends in October, six weeks before the December 15 pay date.

KCI offers the Board unsworn statements of 20 KCI employees<sup>12</sup> who described their community outreach and recruitment efforts in furtherance of full enrollment. KCI Ex. 5. Nineteen (19) statements are dated between March 26 and March 29, 2018 (*id.* at 1-12, 14-20); one is not dated (*id.* at 13). The statements presumably were prepared for purposes of appeal of the January 19, 2018 disallowance. We are not rejecting the statements as entirely unreliable evidence for this single reason. However, all of the statements are generally or broadly worded, and do not discuss the outcome of the efforts toward full enrollment. Importantly, none of them discuss when the outreach and recruitment efforts took place. Thus, we do not have sufficient information to determine whether the statements pertained to outreach and recruitment during the November 2012-October 2013 incentive period for which KCI’s enrollment statistics do indicate KCI had achieved full enrollment.<sup>13</sup> KCI Ex. 13. If the statements concerned efforts made during the November 2013-October 2014 period, as we said earlier, KCI’s own enrollment statistics indicate that full enrollment was not achieved for that entire period. *Id.* In any event, regardless of the incentive period, the employee statements themselves are not proof of whether or not KCI met the stated incentive policy objective of full enrollment.

Relying chiefly on the Board’s decision in *Washington County Opportunities, Inc.*, DAB No. 1464 (1994), in which the Board reversed ACF’s disallowance of a Head Start grantee’s organization-wide bonus payments and determined that the cost principles do not restrict incentive compensation to that which recognizes individual employee

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<sup>11</sup> KCI maintains that its Board of Directors did not have the October 2014 enrollment statistics at the time of the October 21, 2014 Board of Directors meeting and relied in good faith on the KCI Comptroller’s statement to the Board of Directors that full enrollment had been obtained as of the date of the meeting and, thus, incentive compensation had been earned and payable, and paid, in November 2014. KCI Br. at 5, 16, 17; KCI Ex. 12 (October 21, 2014 KCI Board of Directors meeting minutes), at 5 (indicating that KCI’s Comptroller reported on the “2013-14 Employee Incentive Award” and including a statement that “[t]he good news is that this year based on our enrollment, all full time employees would get a 3% incentive bonus”). Regardless of whether the Board of Directors relied in good faith on whatever representation the Comptroller supposedly made during the October 21, 2014 Board of Directors meeting about enrollment levels, KCI’s senior management is responsible for ensuring that KCI’s stated policy is followed and any incentive paid is in accord with that policy.

<sup>12</sup> KCI has over 80 employees. *See, e.g.*, KCI Ex. 11, at 4. KCI has not addressed whether the 20 employees who provided statements constituted all of its employees who met the policy’s stated minimum one-year employment requirement to be eligible to receive incentive compensation.

<sup>13</sup> Even assuming the employee statements pertained to the November 2012-October 2013 period, as we have said earlier, in paying the incentives KCI improperly used funding for one funding period for obligations incurred during an earlier funding period and did so based on a policy that was not properly approved.

achievements, KCI asserts that its incentive compensation payments based on “overall performance” of KCI rather than on individual staff member performance, and based on the availability of funds, were reasonable. KCI Br. at 9-13. It also asserts that a plan to pay incentives based on a full-enrollment objective was based on “proper criteria.” *Id.* at 10 (citing 45 C.F.R. §§ 1302.13, 1302.15) and n.4 (asserting that although 2 C.F.R. Part 230, App. B, ¶ 8.j does not expressly refer to enrollment as a basis for incentive compensation, it does refer to “efficient performance” as a basis and that the bases identified in the regulation are not intended to constitute an exhaustive list of permissible criteria).

The Board determined in *Washington County* that the “mere fact that the bonuses” (which the Board found were, “in principle, incentive payments”) were paid “organization-wide [did] not render them unallowable per se.” DAB No. 1464, at 1 (emphasis in original). But the Board examined the payments to determine their reasonableness, stating that the fact that incentives were paid “organization-wide” nevertheless “may be a factor in determining their reasonableness.” *Id.*; *id.* at 2 (“[T]he fact that Washington County split evenly among all its employees all of the funds remaining at the end of the budget period raises a question of the reasonableness of the payments.” (emphasis in original)) and 11 (similar discussion). The Board concluded that the payments were “incentive-based” and based on “efficient performance” consistent with OMB Circular A-122, and that individual performance evaluations were not a relevant consideration since Washington County gave organization-wide bonuses for staff’s overall performance. *Id.* at 6-8. The Board accordingly overturned the disallowance, but stated that its decision did not preclude ACF from further examining the reasonableness of the payments considering whether the payment was an amount a prudent person would pay under the same circumstances, as well as factors such as Washington County’s compensation levels, compensation levels of comparable workers in the same geographic area, bonuses of similarly situated organizations, and whether Washington County paid any other bonuses to its employees. *Id.* at 11.

In accordance with *Washington County*, the fact that KCI made staff-wide incentive payments, presumably without making individual performance evaluations, does not by itself render the payments unreasonable and thus unallowable. However, the record, as developed by the parties in this appeal, does not provide sufficient information on which we can determine whether KCI’s incentive payments were reasonable in consideration of the types of factors for determining the reasonableness of a cost the Board set out in *Washington County*. In any event, ultimately, the incentive payments at issue are not allowable for the reasons we set out above.

*E. The Board is not empowered to grant equitable relief.*

KCI states that it “strives to be a good steward of its federal funding.” KCI Br. at 2. KCI also informs the Board that it has only two sources of funding – ACF and the Department of Agriculture – and that it did not “willful[ly] attempt to circumvent the stated Incentive Compensation Policy” when it paid its employees incentive compensation in 2014 to “catch-up” for the prior year. Notice of Appeal at 2.

To the extent the above statements may be understood as a request that the Board reverse the disallowance based on equity reasons, it is well-settled that the Board, being “bound by all applicable laws and regulations,” 45 C.F.R. § 16.14, is not empowered to grant equitable remedies. *See Mental Health Ass’n of Or.*, DAB No. 2590, at 9 (2014) (“The Board has no authority to waive a disallowance on the basis of equitable principles.”); *The Children’s Ctr., Inc.*, DAB No. 2506, at 8 (2013) (“[T]he Board is not authorized to reverse a disallowance based on equity.”); *P.R. Dep’t of Health*, DAB No. 2385, at 29 (2011) (and cases cited therein); *Municipality of Santa Isabel*, DAB No. 2230, at 11 (2009) (The grantee’s financial circumstances, unfortunate as they may be, are ultimately irrelevant since the Board may not waive a disallowance for equity reasons.); *River E. Econ. Revitalization Corp.*, DAB No. 2087, at 12 (2007) (“general claim of ‘equity’ . . . is not available as a basis for dispensing federal funds”); *Camden Cnty. Council on Econ. Opportunity*, DAB No. 881, at 7-8 (1987) (“The Board is bound by all applicable laws, and cannot invent equitable remedies without a basis in law.”).

**Conclusion**

For the reasons set out above, we uphold ACF’s disallowance of \$56,393.

\_\_\_\_\_/s/  
Leslie A. Sussan

\_\_\_\_\_/s/  
Constance B. Tobias

\_\_\_\_\_/s/  
Susan S. Yim  
Presiding Board Member