

Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Arlington Community Action DATE: January 2, 2008
 Program, Inc.
 Docket No. A-07-87
 Decision No. 2141

DECISION

Arlington Community Action Program, Inc. (ACAP), a Head Start grantee in Arlington County, Virginia, appeals a determination by the Administration for Children and Families (ACF) disallowing a total of \$520,036 that ACAP charged to its Head Start grant for the fiscal year ending (FYE) June 30, 2005. ACF disallowed the funds on the grounds that ACAP either spent them on costs that are not allowable charges to federal Head Start funds under the applicable cost principles or failed to provide adequate documentation demonstrating that they were allowable charges.

On appeal, ACAP states that it contests the disallowance but that it is no longer in business and has no employees or sufficient funds to engage personnel to review its records and respond to the disallowance. ACAP therefore seeks equitable relief from the disallowance and requests that the disallowed amount be deemed uncollectible. As explained below, we sustain the disallowance.

Applicable law, regulations, and policies

Cost principles applicable to Head Start grantees such as ACAP provide that, in order for a grantee's costs to be allowable charges to federal grant funds, the costs must be reasonable for the performance of the grant award and allocable thereto.¹

¹ Head Start is a national program providing comprehensive developmental services, including health, nutritional, educational, social and other services, to economically disadvantaged preschool children and their families. 42 U.S.C. § 9831. The Department of Health and Human Services (HHS), through ACF, provides funds to grantees to serve as Head Start
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Office of Management and Budget Circular A-122 (OMB A-122), Attachment (Att.) A, ¶ A.2.a, codified at 2 C.F.R. Part 230 and made applicable to HHS grants to non-profit organizations including Head Start grantees by federal regulations at 45 C.F.R. §§ 74.27(a), 1301.10(a). A cost is reasonable if it is the type generally recognized as ordinary and necessary for the operation of the organization or performance of the award, and allocable to the award in accordance with the relative benefits received. OMB A-122, Att. A, ¶¶ A.3.a, A.4.

To be allowable, costs claimed under an award must also be adequately documented. Id. at ¶ A.2.g. The regulations require a grantee to have in place a financial management system that provides “[r]ecords that identify adequately the source and application of federal funds” 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). In appeals of disallowances, the Board has consistently held, based on these principles, that a grantee is required to document its costs, and bears the burden of demonstrating the allowability and allocability of costs for which it received federal funding. See, e.g., Marie Detty Youth and Family Services Center, Inc., DAB No. 2024, at 3 (2006), citing Council of the Southern Mountains, DAB No. 1861, at 3 (2003), Texas Migrant Council, Inc., DAB No. 1743, at 4 (2000), and additional decisions cited in both.

Other cost principles are relevant to this disallowance. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award. OMB A-122, Att. A, ¶ A.4.b. Additionally, where a grant award specifies a funding period, a recipient may charge to the award “only allowable costs resulting from obligations incurred during the funding period” (and any approved pre-award costs). 45 C.F.R. § 74.28. The Board has thus held that expenditures incurred outside their grant periods necessarily are not allocable to the grants and are subject to disallowance. River East Economic Revitalization Corp., DAB No. 2087, at 6 (2007), citing Delta Foundation, Inc., DAB No. 1710, at 41 (1999) (aff’d 303 F.3d 551, 568-570 (5th Cir.

¹(...continued)

agencies within designated communities and periodically reviews their performance in meeting program and fiscal requirements. See generally 42 U.S.C. § 9836.

2002)), further citing Bedford Stuyvesant Restoration Corp., DAB No. 1404, at 15 (1993).

Background

The disallowance resulted from an audit of ACAP's Head Start costs for FYE 2005 by the Office of the Inspector General of the Department of Health and Human Services (OIG). The OIG conducted the audit to determine whether the costs ACAP claimed for the Head Start program were allowable under the terms of ACAP's Head Start grant, applicable federal regulations and OMB guidance. ACF Ex. 1 (OIG audit report). As a result of the audit, the OIG recommended that ACAP refund \$342,004 in costs that were unallowable or unsupported. Id. at 7-8. The OIG identified these costs as consisting of salaries and wages that were unrelated to the Head Start program or unallowable based on ACAP's personnel policies and procedures; leave allocation costs for paid absences that were either unsupported or unallowable based on ACAP's personnel policies and procedures; payroll taxes (federal, Social Security, and Medicare) that ACAP withheld from Head Start employees but did not remit to the IRS; travel expenses that exceeded the allowable per diem amount or were unsupported or duplicated claimed costs; expenses for purchases that were unsupported, made prior to or after the grant period or were for supplies covered by another federal grant; other direct costs that were overstated or unsupported; and indirect costs calculated based on the unallowable direct costs. Id. at 7-8, 11-14.

The OIG also identified another \$178,032 in costs for which the OIG found that ACAP had insufficient supporting documentation. While ACAP had supporting documentation such as payment vouchers, invoices, check stubs and canceled checks, it did not provide other documentation that the OIG needed to determine whether the costs were "properly authorized, reasonable, allocable, received or used for the Head Start program," such as "purchase requisitions, purchase orders, travel vouchers with receipts, method for allocating certain expenses, or delivery receipts" for goods and services purchased. Id. at 7-8. These costs were claimed for salaries and wages, travel, supplies, other direct costs, and related indirect costs. Id. at 11. Because the OIG lacked adequate documentation to support those costs, it set them aside for future resolution between ACF and ACAP. Id. The audit report states that the OIG's determination for not accepting and setting aside the questioned costs was based on OMB A-122, which, the report noted, states that to be allowable under an award, costs must be reasonable, allocable and adequately documented. Id.

ACF, in its disallowance letter, reported that as ACAP had not provided an acceptable response to the OIG findings, ACF was disallowing the entire amount of the questioned costs.²

Discussion

On appeal, ACAP states that it contests the OIG's determinations that \$342,004 that ACAP charged to Head Start funds were unsupported or unallowable and that ACAP failed to provide sufficient supporting documentation to determine the allowability of \$178,032 that ACAP charged to Head Start funds and that ACF subsequently disallowed. However, ACAP presents no argument or analysis as to why the disallowance determination is incorrect and has made no attempt here to document the costs. Instead, ACAP argues that the disallowed amounts should be deemed uncollectible and requests equitable relief from the disallowance. ACAP reports that it ceased doing business and asserts that it does not have any employees or sufficient resources to review, research and analyze its records in order to assess the accuracy or correctness of the disallowance findings, and is unable to repay the disallowed funds. In this vein, ACAP asserts that it was presented with the OIG audit findings "literally a few days" before ACAP was set to terminate operations.³ ACAP Br. at 2.

² The audit report also notes that ACAP did not have adequate financial management practices to support Head Start costs as required by federal regulations. Specifically, the OIG found, ACAP did not maintain segregation of duties over its accounting functions, did not timely record costs charged against the grant, did not always document the methodology used to allocate certain costs, did not maintain adequate documentation to validate the costs claimed, and did not have effective control over and accountability for all funds, property, and other assets. ACF Ex. 1, at 5. Further, the audit report notes that ACF reviews of ACAP's Head Start program had identified fiscal areas of noncompliance with Head Start requirements and that ACF had designated ACAP as a high-risk organization for failure to maintain proper internal controls to safeguard Head Start assets. Id. ACF's disallowance letter states that ACF would not pursue corrective action because ACAP was no longer a Head Start grantee.

³ The record does not indicate the date that the audit report was transmitted to ACAP, but the audit report states that the OIG auditors discussed their findings with ACAP officials

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The Board does not have the authority to grant the equitable relief that ACAP seeks. The Board is bound by applicable laws and regulations, including the cost principles cited above that the regulations make applicable to ACAP's Head Start grant, and has no authority to waive a disallowance. 45 C.F.R. § 16.14; see, e.g., Bedford Stuyvesant Restoration Corp. at 20 (1993) (the Board is "empowered to resolve legal and factual disputes" and "cannot provide equitable relief"). That ACAP may have ceased operations and exhausted its assets is not relevant to our consideration of this disallowance. See Juniata County Child Care and Development Services, Inc., DAB No. 2089, at 5 (2007) ("the burden or financial hardship which repayment might cause the grantee is not relevant to our consideration of whether grant costs are allowable"); Bedford Stuyvesant Restoration Corp. at 20 (the grantee's "possible bankruptcy is not relevant to our consideration of these, or any, disallowances"). Thus, in response to allegations of inability to repay a disallowance, the Board has stated that it does not have authority to forgive a disallowance where the grantee does not contest the legal or factual basis of the disallowance but merely seeks equitable relief. Huron Potawatomi, Inc., DAB No. 1889, at 9 (2003), citing Harambee Child Development Council, Inc., DAB No. 1697 (1999).

ACAP argues that this case is distinguishable from Huron Potawatomi, Inc. on the ground that ACAP, unlike the appellant in that decision, does contest its liability for the disallowance, but lacks resources to respond. At the outset, we question ACAP's premise that Huron Potawatomi did not contest its liability for the disallowance, since Huron Potawatomi did argue that it had accounted for all disallowed funds.⁴ We also do not

³(...continued)

throughout the course of the audit. ACF Ex. 1, at 4, 7. The audit report also states that on March 27, 2006, ACAP officials informed the auditors that ACAP would relinquish the Head Start grant for the fiscal year beginning July 1, 2006 and would dissolve ACAP as a non-profit organization effective June 30, 2006. Id. at 8. ACAP reports that it ceased doing business on June 30, 2006, but continued to have some employees until the end of September 2006. ACAP Br. at 1.

⁴ In any event, contrary to its attempt to distinguish Huron Potawatomi, Inc., ACAP does concede the factual basis for at least a portion of the disallowance -- \$124,124 comprising ACAP's claims for payroll taxes (\$58,861 in federal income taxes (continued...))

agree that ACAP has put the disallowance in dispute by merely asserting that it disputes the disallowance without stating any particular reasons or bases as to why it disputes the disallowance. ACAP has not identified any specific finding or conclusion in the OIG audit report or in ACF's disallowance letter that it disputes, and has provided no grounds for the Board to question the basis for or reverse any portion of the disallowance.

Even assuming that ACAP contests the legal or factual bases for the disallowance (as opposed to merely contesting ACAP's consequent obligation to repay the disallowed funds), that would not provide any basis to reverse the disallowance. ACAP's obligation to document that all of the costs it charged to Head Start funds were allowable under the costs principles and allocable to its Head Start grant applied before ACAP received the OIG audit report. ACAP's inability to produce such documentation now cannot excuse its failure to have maintained contemporaneous documentation, as required by 45 C.F.R. §§ 74.21(b)(2), (b)(7), or to have produced it during the OIG audit.⁵ In this respect, we note that the audit report states that the OIG auditors conducted the audit at ACAP from August 2005 through March 2006, well before ACAP reports having ceased operations, and discussed their findings with ACAP officials throughout the course of the audit. ACF Ex. 1, at 4, 6-7.

ACAP's obligation to document its costs did not end when ACF took the disallowance. A grantee's burden to support its claims with documentation in response to a disallowance applies when the federal agency taking the disallowance has articulated the basis with sufficient detail to allow the grantee to respond. Delaware Dept. of Health and Social Services, DAB No. 1166, at 10 (1990); see also 45 C.F.R. § 74.90(c)(2) (a notice of disallowance must contain enough information to enable the grantee to understand

⁴ (...continued)

and \$65,263 in Social Security and Medicare taxes) that ACAP withheld from Head Start employees but did not remit to the IRS, ACF Ex. 1, at 8, 12, 13 -- by acknowledging that the withheld payments were not forwarded to the IRS. ACAP Br. at 1.

⁵ The regulations further provide that all documents pertinent to a grant award shall be retained for a period of three years from the date of the submission of the quarterly or annual financial report, or until "all litigation, claims or audit findings involving the records have been resolved and final action taken." 45 C.F.R. § 74.53(b).

the issues and the agency's position). Here, ACAP does not assert that it does not understand why ACF determined that the questioned costs were unallowable, and does not assert that it does not have sufficient information about the bases for the disallowance to permit it to respond. ACAP's mere assertion that it contests the disallowance does not negate its failure to document the allowability of all of its charges to federal funds, and provides no basis for this Board to question the OIG audit findings or to reverse the disallowance.

ACAP also appears to seek relief from the portion of the disallowance attributable to payroll taxes that ACAP did not remit to the IRS on the ground that this failure was attributable to employee malfeasance. ACAP asserts that it "was victimized by staff members who failed to remit withholding taxes to the IRS" over at least the period of 2002 through 2005, which ACAP did not discover until around August 2005. ACAP Br. at 1. ACAP reports that it owes the IRS in excess of \$1.5 million in taxes, interest and penalties as a result of the failure to remit the withheld funds. Id.

The actions of ACAP's employees do not excuse its failure to use federal Head Start funds for allowable purposes. A grantee is responsible for the management of its program and the supervision of its employees, and cannot rely on employee mismanagement or misdeeds as a reason to avoid its obligation to account for federal grant funds. See, e.g., Juniata County Child Care and Development Services, Inc. at 3-4 (2007) (grantee's allegations that its former executive director destroyed documentation needed to establish the allowability of disallowed costs, even if true, would not mean that the grantee "can evade its responsibility to account for the federal funds it received"), citing Utica Head Start Children and Families, Inc., DAB No. 1749, at 18 (2000) (under 45 C.F.R. § 1304.50(g)(1) and (2), Head Start grantee "had to have written policies that defined the responsibilities of its governing body, its board of directors, and in turn had to ensure by means of those policies that appropriate internal controls were established and implemented to safeguard federal funds"); Huron Potawatomi, Inc. at 8 (rejecting argument that the grantee should not be held responsible for mismanagement by former employees), citing Action for Youth Christian Council, Inc., DAB No. 1651, at 15 (1998) (grantee "responsible for the proper administration of its grant program, despite any problems it asserts it had with staff or its Board").

Conclusion

For the forgoing reasons, we sustain the disallowance.

_____/s/
Judith A. Ballard

_____/s/
Leslie A. Sussan

_____/s/
Sheila Ann Hegy
Presiding Board Member