

Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Economic Opportunity Commission of Nassau County, Inc.
Docket No. A-16-38
Decision No. 2731
August 24, 2016

DECISION

Economic Opportunity Commission of Nassau County, Inc. (EOC), a Head Start grantee, appeals the September 29, 2015 determination by the Office of Head Start, Administration for Children and Families (ACF) disallowing \$879,876 in employee salary and fringe benefit costs for 78 employees for the August 1, 2010 through July 31, 2011 period. ACF based the determination on a September 2013 Office of Inspector General (OIG) audit report. ACF determined that the disallowed salary and fringe benefit costs were not documented with personnel activity reports as required under the applicable regulations and Office of Management and Budget (OMB) cost principles.

For the reasons explained below, we uphold the disallowance.

Legal Background

A Head Start grantee must (with some exceptions not relevant here) comply with the grant administration requirements in 45 C.F.R. Part 74.¹ 45 C.F.R. § 1301.10. The Part 74 regulations require grantees to comply with standards of financial management. 45 C.F.R. §§ 74.20, 74.21. A grantee must have financial management systems that provide “[a]ccurate, current and complete disclosure of the financial results of each HHS-sponsored project” and “[e]ffective control over and accountability for all funds,” ensuring that funds “are used solely for authorized purposes.” *Id.* § 74.21(b)(1), (b)(3).

¹ Effective December 26, 2014, Part 74 of Title 45 of the Code of Federal Regulations was superseded by the “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards” published in 45 C.F.R. Part 75.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. 75,872, 75,875-76 (Dec. 19, 2014). We cite to the Part 74 regulations because they were in effect during the award period at issue here.

The Part 74 regulations require a nonprofit grantee to comply with OMB Circular A-122, “Cost Principles for Non-Profit Organizations.”² *Id.* §§ 74.2, 74.27(a). To be “allowable” under the cost principles, costs must be reasonable for the performance of the award, allocable to the award, and adequately documented. 2 C.F.R. Part 230, App. A, ¶ A.2.a, g. “A cost is allocable to a particular cost objective, such as a grant ..., in accordance with the relative benefits received.” 2 C.F.R. Part 230, App. A. ¶ A.4.a.

A grantee’s charges to an award for salaries and wages must be based on documented payrolls approved by a responsible official, and the grantee must keep reports showing the distribution of activity of each employee. *Id.* App. B, ¶ 8.m. “The distribution of salaries and wages to awards must be supported by personnel activity reports” that: (1) “reflect an after-the-fact determination of the actual activity of each employee”; (2) “account for the total activity for which employees are compensated ...”; (3) are “signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee [and indicate] that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports”; and (4) are “prepared at least monthly” and “coincide with one or more pay periods.” *Id.* ¶ 8.m.(1)-(2).

Case Background

EOC is a nonprofit organization that operates seven Head Start centers, serving approximately 600 children, throughout Nassau County, New York. ACF Ex. 2, at 1. From February through June 2012, the OIG conducted an on-site audit at EOC’s administrative office. ACF Ex. 1, Declaration of Steven M. DeGroff (DeGroff Decl.) ¶ 3; ACF Ex. 2, at 2. The auditors reviewed \$332,862 of EOC’s expenditures for the July 1, 2009 through September 30, 2010 period under an award funded by the American Recovery and Reinvestment Act of 2009, P.L. No. 111-5 (Recovery Act). *Id.* The auditors also reviewed \$6,955,243 in regular Head Start expenditures for the August 1, 2010 to July 31, 2011 period. *Id.* The audit’s purpose was to determine whether EOC’s expenditures were allowable under the terms of its grants and the applicable federal regulations. *Id.*

The OIG determined that all of EOC’s claimed Recovery Act expenditures were allowable. ACF Ex. 2, at 2; DeGroff Decl. ¶ 4. The OIG further determined, however, that \$879,876 in Head Start salary and fringe benefit costs for 78 employees was

² Until 2014, OMB Circular A-122 was codified in Appendices to 2 C.F.R. Part 230. *See* 70 Fed. Reg. 51,910 (Aug. 31, 2005); 2 C.F.R. Part 230 (Jan. 1, 2013). This decision cites to, and quotes from, that codification. In December 2013, the OMB consolidated the content of OMB Circular A-122 and eight 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).

unallowable because the costs were not properly documented with personnel activity reports as required under 2 C.F.R. Part 230, App. B, ¶ 8.m. ACF Ex. 2, at 2; DeGross Decl. ¶¶ 4, 5. Specifically, the report stated that staff at two of EOC's Head Start centers and at EOC's administrative office did not always record their time spent on federal awards. On September 29, 2015, ACF issued a determination disallowing \$879,876 in undocumented salary and fringe benefit costs for 78 employees based on the OIG audit report. Notice of disallowance at 3.

Analysis

When a grantee appeals a federal agency's disallowance determination, the agency has "the initial burden to provide sufficient detail about the basis for its determination to enable the grantee to respond." *E Center*, DAB No. 2657, at 5 (2015)(citing *Me. Dep't of Health & Human Servs.*, DAB No. 2292, at 9 (2009), *aff'd*, *Me. Dept. of Human Servs. v. U.S. Dept. of Health & Human Servs.*, 766 F. Supp. 2d 288 (D. Me. 2011)). If the agency carries this burden, then the grantee must demonstrate that the costs are allowable. DAB No. 2657, at 5 (citing *Mass. Exec. Office of Health & Human Servs.*, DAB No. 2218, at 11 (2008), *aff'd*, *Mass. v. Sebelius*, 701 F. Supp. 2d 182 (D. Mass. 2010)). "When a disallowance is supported by audit findings, the grantee typically has the burden of showing that those findings are legally or factually unjustified." *Id.* The Board has consistently held that the regulations and cost principles impose on a grantee the burden to document that disputed costs were actually incurred and represent allowable costs, allocable to the grant. *Norwalk Economic Opportunity Now, Inc.*, DAB No. 2543, at 2 (2013)(citations omitted).

ACF met its burden in support of the disallowance

In this case, ACF provided detailed information about the basis of its determination. ACF's disallowance notice stated that ACF based its determination on the audit findings and conclusions in the September 2013 OIG Audit Report A-02-12-02003, "Economic Opportunity Commission of Nassau County, Inc., Claimed Some Unallowable Head Start Costs". Notice of disallowance at 1-2. The audit report, in turn, described the OMB documentation requirements for employee salaries and wages at 2 C.F.R. Part 230, Appendix B, section 8.m. ACF Ex. 2, at 1-2. The audit report stated that for the August 1, 2010 to July 31, 2011 period, EOC "did not adequately document salary and fringe benefit costs totaling \$879,876 related to 78 of its 173 employees that reportedly worked on EOC's Head Start grant during [the] audit period." *Id.* at 2. While the audit found that "staff at five of EOC's seven Head Start centers wrote how much time they spent on Federal awards on time and attendance sheets ..., staff at the remaining two Head Start centers and at EOC's administrative office did not always record their time spent on Federal awards." *Id.* at 3. The report further explained, "This occurred because EOC did not update its policies and procedures for time and effort reporting when it implemented a

new time and attendance system in January 2010.” *Id.* at 2. The report also noted that in written comments to the draft report, EOC provided what it described as “Personnel Change Authorization” forms as documentation for the questioned costs. The auditors concluded, however, that the forms did “not reflect after-the-fact determinations of employee activity” required by the applicable cost principles. *Id.* at 3. We thus conclude that ACF met its burden to provide sufficient detail about the basis for the disallowance. EOC was therefore obligated to demonstrate that the audit findings are, in fact, incorrect.

EOC did not meet its burden to document the allowability of the disputed costs

We conclude that EOC has not met its burden to document the allowability of the costs at issue. Notably, EOC’s initial arguments and submissions on appeal did not accurately represent EOC’s time and attendance procedures or the documentation it kept during the August 1, 2010 to July 31, 2011 period. EOC initially argued that it “had a protocol in place during the period” at issue that “evidences full compliance with the requirements of [OMB Circular] A-122 and within the meaning of the four-factor analysis of Part 230.” EOC Br. at 2. “First,” EOC stated, it “maintained time sheets for each employee working in the Head Start Program which reflected after-the-fact actual activity of the employee.” *Id.* EOC specified, “Each employee has a ‘Daily Summary’ of hours worked, as well as a ‘Quick Report,’ which contain handwritten notations of management approval, the percentage of time the employee worked in the Head Start Program (indicated by the initials ‘HS’), as well as the total hours worked during the pay period.” *Id.* EOC explained, “The manager’s signature of approval, by implication, evidences that the estimate of the time worked by the employee was reasonable.” *Id.* EOC submitted samples of the “Daily Summaries” and “Quick Reports” timesheets described in its brief (EOC Ex. A) and stated that documentation evidencing compliance for all employees could be made available to the Board on request.

However, EOC revised its representations about its timekeeping practices and exhibits after ACF submitted its response brief and exhibits, arguing and showing that EOC had altered the personnel activity reports it submitted on appeal and that the altered reports were not the same reports that the OIG auditors reviewed when they conducted the on-site audit. ACF Br. at 6-10; DeGroff Decl. ¶¶ 6, 7, Ex. 1. While the reports EOC submitted on appeal contained either handwritten notations of the percentages of time the employees worked on Head Start and other programs, or a typed chart indicating 100% of the employee’s work related to Head Start, the reports reviewed during the on-site audit lacked any allocation of the employees’ time. *Id.*

EOC’s reply acknowledged that EOC “did make additional notations on a sampling of the employee time sheets subsequent to the OIG Audit date for illustrative purposes,” but did not mean to mislead the Board. EOC Reply at 2. EOC stated, “It was the misunderstanding of Appellant-Counsel that the handwritten notations ... were also part

of the Appellant's new record keeping system during the period of the OIG Audit.” *Id.* EOC then asserted that the allocations of the employees’ time that EOC added to the time sheets after the audit “were intended to illustrate and compare compliance with the requirements of A-122. . . .” EOC further argued that its time and attendance system consists of “multiple software applications to track and record employee[s]’ time and activities.” *Id.* This system, EOC stated, “produces several reports that, taken together, satisfy the cost principles” and demonstrate that EOC “undertook all reasonable actions to ensure it was in compliance with the requirements of A-122.” EOC Reply at 2, 6. To support this argument, EOC submitted the above-described sample timesheets (“Daily Summaries” and “Quick Reports”)(EOC Ex. A); sample “Labor Distribution Reports” (EOC Ex. B); sample “Payroll Transfer Schedules” (EOC Ex. C); a “Distribution Codes List” (EOC Ex. D); and sample “Personnel Change Authorization forms” (EOC Ex. E). EOC also argued that 68 of the 78 employees whose activity reports were questioned were exclusively assigned to the Head Start Program, and that, therefore, “effort reporting would be irrelevant where the employees are not compensated from any other funding source other than Head Start.” EOC Reply at 5. Under the circumstances, EOC argued, a disallowance of the questioned expenditures “would be unduly harsh, and patently unfair” *Id.* at 6.

The documentation submitted by EOC to support the disputed costs does not satisfy the applicable federal requirements. As set forth above, the cost principles governing a grantee’s charges to an award for salaries and wages are detailed and precise. The costs must “be based on documented payrolls approved by a responsible” organization official. 2 C.F.R. Part 230, App. B, ¶ 8.m.(1). Furthermore, the grantee must maintain **“personnel activity reports . . . reflecting the distribution of activity of each employee . . . for all staff members . . . whose compensation is charged, in whole or in part, directly to awards.”** *Id.* App. B, ¶ 8.m.(1)-(2)(emphasis added). The “personnel activity reports” must: (1) “reflect an **after-the-fact determination of the actual activity of each employee**”; (2) “account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization”; (3) “be **signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed** by the employee [and indicate] that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports”; and (4) “be **prepared at least monthly**” and “coincide with one or more pay periods.” 2 C.F.R. Part 230, App. B, ¶ 8.m. (emphasis added).

EOC contends in its appeal that the “Daily Summaries” and “Quick Reports” timesheets maintained during the period in dispute and questioned by the auditors satisfy the applicable requirements. *See* EOC Br. at 2. These documents included the employee name, pay period, total hours worked, pay types (“SAL,” “OTHR,” “VAC,” “UNAP,” “SICK,” “REG,” “PERS”), and a checked box indicating that the time reported had been

approved by a supervisor. DeGroff Decl. Ex. 1. The “Daily Summaries” and “Quick Reports,” however, were devoid of information showing the distribution of activity for each employee whose compensation was charged, in whole or part, to EOC’s Head Start grants. *Id.*

Furthermore, as the OIG had already advised EOC, the “Daily Summaries” and “Quick Reports” that EOC altered after the auditors’ on-site visit to show the allocation of the employees’ work to different federal awards do not satisfy the documentation requirements of the cost principles. ACF’s brief and the senior auditor’s declaration note that EOC provided the OIG with similarly-altered documentation before the OIG issued the final audit report. ACF Br. at 7; DeGroff Decl. ¶ 8. When the auditors asked EOC’s comptroller when the effort allocations were added to the reports, EOC stated that they were added in response to the OIG’s proposed audit finding. *Id.* The auditors explained that they could not accept the altered documentation as proof that EOC maintained the required personnel reports during the August 2010 – July 2011 period. *Id.*

We agree with the auditors. Under 2 C.F.R. Part. 230, App. B, ¶ 8.m., a grantee’s personnel activity reports must reflect an after-the-fact determination of the actual distribution of activity of each employee, be signed by the employee (or a responsible supervisory official with first-hand knowledge of the activities), and be prepared at least monthly. *Id.* Because EOC added the allocation of effort information to the reports many months after the audit period (August 1, 2010 – July 29, 2011), the altered records do not satisfy the documentation requirement that reports reflecting the distribution of activity of each employee be prepared on at least a monthly basis and be signed by the employee or supervisor indicating that the time allocation is a reasonable estimate of the actual work performed during that pay period.

We further reject EOC’s argument that the different time and attendance reports EOC kept during the audit period, taken together, fully satisfy the cost principles. EOC states that it uses multiple software programs to track and record employees’ time and activities. According to EOC, “employees enter ... hours worked into the Time Star Software daily to record attendance and assignments.” EOC Reply at 2. “At the end of the pay period, time sheets from Time Star are created and transported into” another software system “to generate Labor Distribution Reports and Payroll Transfer Schedules.” *Id.* at 2-3. EOC further explains, “Upper management utilizes these reports to determine [the] accuracy of time sheets and total activity dedicated to each program.” *Id.* at 3. In sum, EOC asserts, it met the “basic requirements” of the cost principles as follows: 1) “The employee timesheets evidence an after the fact determination of employee activity in that the time sheets were prepared at the end of the pay period after each employee rendered services”; 2) “Each time sheet accounts for the total activities for which” each employee is compensated, and [o]nce the timesheets are inputted in the record keeping system, a Labor Distribution Report is created which identifies the

allocation of time the employee spent working in the Head Start Program” or other programs. “This report is followed by a Payroll Transfer Schedule which indicates the salaries paid for the work performed”; 3) “Each timesheet is signed by the employee and their supervisor attesting, by implication, to the reasonableness of the hours worked”; and 4) All of the reports “were prepared contemporaneously with each bi-weekly payroll.” *Id.*

We find that EOC’s characterizations of its documentation are not supported by the evidence. Specifically, while the Labor Distribution Reports, together with the Distribution Codes List, contain summary percentages of each employee’s work allocated to different matters during a pay period, the reports do not show the bases for the summary percentages. EOC Exs. B, D. While EOC’s brief states that the data entered into the system to generate the Labor Distribution Reports was “inputted” from the timesheets, the “Daily Summaries” and “Quick Reports” timesheets, discussed at length above, contain no such data. Moreover, the Labor Distribution Reports were not signed by the individual employees or a responsible supervisory official to indicate that the percentage distribution of activities on the summary reports represented a reasonable estimate of the actual work performed by the employees during the pay periods covered by the reports. Accordingly, we reject EOC’s claim that the employee and supervisor signatures on the timesheets attest, by implication, to the reasonableness of the hours attributable to different efforts.

The Personnel Change Authorization forms likewise are insufficient to meet the wages and salaries documentation requirements. The Personnel Change Authorization forms include summary notations in the “Remarks” section of the forms indicating a change or adjustment to an employee’s work hours or employment status when a change was required. EOC Ex. E. The forms do not, however, constitute “after-the-fact” determinations of the actual activity of each employee for a specific time period, signed by the individual employee, or by a responsible supervisory official having first-hand knowledge of the activities as representing a reasonable estimate of the work performed by the employee.

Lastly, as noted above, EOC asserts that the disallowance “would be unduly harsh, and patently unfair to the Appellant, who has otherwise demonstrated excellent stewardship in the operation and administration of its Head Start Program, as well as its commitment to be in full compliance with the cost principles of A-122 and Circular 230.” EOC Reply at 6. EOC’s argument, based on equitable principles, does not establish a basis for overturning a legally justified disallowance. The Board has consistently held that it “has no authority to waive a disallowance based on equitable principles.” *Municipality of Santa Isabel*, DAB No. 2230, at 10-11 (2009); *accord Bedford Stuyvesant Restoration Corp.*, DAB No. 1404, at 20 (1993) (citing 45 C.F.R. § 16.14 and stating that the Board “is bound by all applicable laws and regulations” and “cannot provide equitable relief”). As discussed above, the regulations and cost principles governing the documentation

required to support a nonprofit grantee's charges to an award for salaries and wages are detailed and specific, applying to all employees whose compensation is charged in whole or in part to a federal award. 2 C.F.R. Part 230, App. B, ¶ 8.m. The applicable cost principles and regulations here authorized ACF to disallow the claimed salary and fringe benefit costs charged to EOC's Head Start awards.

Conclusion

For the reasons discussed above, we sustain the disallowance.

/s/
Leslie A. Sussan

/s/
Susan S. Yim

/s/
Christopher S. Randolph
Presiding Board Member