

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

Piedmont Community Actions, Inc.
Docket No. A-14-38
Decision No. 2595
September 29, 2014

DECISION

Piedmont Community Actions, Inc. (PCA) appeals a determination by the Administration for Children and Families (ACF). ACF disallowed \$135,722 that PCA had charged to Head Start or Early Head Start funds and requested that PCA repay that amount. Based on a review by a contractor, ACF found that the indirect cost rates that PCA had negotiated with the Division of Cost Allocation (DCA) for the years ending December 31, 2009, 2010, 2011 and 2012 were too high. An indirect cost rate is a method for allocating indirect costs (that is, costs that cannot be readily identified with a particular final cost objective) among all of the activities that benefit from those costs. ACF determined that, because the negotiated rates were overstated, PCA had charged to Head Start and Early Head Start awards \$109,294 in indirect costs that did not benefit those awards (an amount ACF later revised to \$109,218). In addition, ACF determined that PCA had used \$26,427.92 in supplemental Head Start funds for unauthorized purposes (work on a parking lot, renovation of an existing Head Start center, and a community assessment).

On appeal, PCA argues that its negotiated indirect cost rates were correct and that they were not subject to adjustment because they had been approved by DCA as final rates for the years in question. PCA challenged ACF's conclusion that certain management fees that PCA received from related parties were "applicable credits" that reduced its indirect costs for administrative services. PCA asserts that it consistently treated all of its costs for administrative services as indirect costs in accordance with the applicable cost principles. Even assuming that the indirect costs were overstated, PCA contends, ACF incorrectly calculated revised rates and the disallowance amount. PCA also argues that the community assessment was allowable under the terms of the supplemental award, and that the unallowable costs for the parking lot and center renovation should be offset by local funds PCA expended for architectural fees. PCA sent ACF a check for \$32,304.96, which PCA says is the maximum amount by which PCA overcharged its ACF awards.

For the reasons stated below, we conclude that PCA's indirect cost rates were likely overstated for the relevant years and that a disallowance of some amount of indirect costs is likely justified. PCA's indirect cost proposals did not reduce the indirect cost pools either by the management fees it received or by the costs of administrative services provided to the related parties, nor did they include the direct costs of the related parties' projects in the direct cost base used to distribute the costs. None of the projects in the direct cost base benefited from the administrative services provided to the related parties' projects. PCA does not claim that it informed DCA about the management fees during the rate negotiations. Thus, it appears that the information PCA provided was materially incomplete and that, under the terms of the indirect cost rate agreements, the rates were subject to renegotiation at the discretion of the federal government, even though they were final rates. It also appears that, for two of the years in question, the rates resulted in ACF awards paying for some of the indirect costs for which PCA had received management fees and for which PCA was therefore paid twice.

Since DCA (which negotiated the rates with PCA) did not participate in this proceeding, however, we cannot definitively determine whether the information used in establishing the rates was materially incomplete or, if so, whether DCA should renegotiate the rates – a decision that would affect all federal awards, not just ACF's awards. Moreover, we have identified flaws in how each party calculated revised indirect cost rates for the years in question and the effect of the revised rates on charges to ACF's awards for indirect costs. Thus, we remand the indirect cost issues so that (1) DCA can decide whether to renegotiate the rates for some or all of the years in question, and (2) if revised rates are negotiated for any period, ACF can recalculate the amount, if any, of unallowable indirect costs charged to its awards, consistent with our analysis below.

We further conclude that ACF properly disallowed the \$26,427.92 in direct costs that PCA charged to its supplemental award and that PCA has not provided documentation sufficient to show that it may substitute the architectural fees for some of the disallowed costs. Thus, we uphold the disallowance of the direct costs.

I. Legal background

PCA is a non-profit organization. During the years at issue here, federal awards to non-profit organizations (including Head Start grants) were governed by the administrative requirements in 45 C.F.R. Part 74, and the cost principles in Office of Management and

Budget (OMB) Circular A-122, then codified at 2 C.F.R. Part 230 (2008-2013)(Part 230). See 45 C.F.R. § 74.27 (2008-2013); 45 C.F.R. 1301.10(a); 70 Fed. Reg. 51,927 (Aug. 31, 2005).¹

Appendix A to Part 230 set out general principles, and Appendix B set out principles for selected items of cost. The following provisions of Appendix A, among others, are relevant to the issues regarding PCA's indirect cost rates:

- Paragraph A.1 provides that the “total cost of an award is the sum of the allowable direct costs and allocable indirect costs less any applicable credits.”
- Paragraph A.4 provides:
 - “Allocable costs. a. A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:
 - (1) Is incurred specifically for the award.
 - (2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received; or
 - (3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.
 - b. 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.”
- Paragraph A.5. defines the term “applicable credits” as follows: “a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. . . .
 - b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. . . .”

¹ As ACF points out, OMB amended its Circulars that provide guidance for federal awards on December 26, 2013. 78 Fed. Reg. 78,590 (Dec. 26, 2013). Contrary to what ACF suggests, however, the relevant date for determining what requirements apply is not the date of the disallowance notice. ACF Br. at 5 n.4. Instead, the applicable requirements are those in effect when the award is made, unless the parties agree otherwise. See, e.g., 2 C.F.R. § 230.40; *Bennett v. New Jersey*, 470 U.S. 632, 639-640 (1985). Moreover, the OMB guidance applies to federal agencies and governs federal awards only when implemented by the federal agencies. 78 Fed. Reg. at 78,621; 2 C.F.R. § 200.110.

- Paragraph B. 1. provides: “Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost”
- Paragraph C.1. provides: “Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in subparagraph B.2. of this appendix. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.”

Depending on the organization’s functions, indirect costs may be accumulated into an indirect cost grouping (or pool) or into separate, multiple cost groupings and then allocated to benefitting functions through use of an indirect cost rate or rates. A simplified allocation method of determining an indirect cost rate may be used “[w]here an organization’s major functions benefit from its indirect costs to approximately the same degree” or “where an organization has only one major function encompassing a number of individual projects or activities “ or “the level of Federal awards to an organization is relatively small.” App. A, ¶ D.2. This method of computing a rate should also be used by organizations that treat all costs as direct costs except “general administration and general expenses.” App. A, ¶ D.4. Examples of general administration and general expenses are the salaries and expenses of executive officers, personnel administration, and accounting. App. A, ¶ C.2.

Under the simplified method, the organization’s total costs for a base period are classified as either direct or indirect, and then the “total allowable indirect costs (net of applicable credits)” are divided by “an equitable distribution base,” generally modified total direct costs, total direct salaries and wages, or “other base which results in an equitable distribution.” App. A, ¶ D.2. The result of this process is an indirect cost rate, expressed as the “percentage which the total amount of allowable indirect costs bears to the base selected.” *Id.* This percentage is then used to distribute indirect costs to individual awards according to what part of the direct costs in the distribution base is allocable to each award. For example, if total indirect costs are \$25,000 and total direct salaries and

wages (the selected distribution base) are \$100,000, the indirect cost rate would be 25%. If an individual award had direct salaries and wages of \$40,000, then \$10,000 in indirect costs (25% of \$40,000) would be distributed to that award by applying the indirect cost rate to that part of the distribution base.²

An organization that wishes to claim indirect costs under a federal award must prepare an indirect cost proposal and submit it to the federal agency (called a “cognizant agency”) designated for the negotiation and approval of indirect cost rates for that organization on behalf of all federal agencies. App. A, ¶ E. Other concerned federal agencies have an opportunity to participate in the negotiation process. *Id.* The results of each negotiation are “formalized in a written agreement between the cognizant agency and the non-profit organization” and, “after a rate has been agreed upon, it will be accepted by all Federal agencies.” *Id.* There are four types of rates (“predetermined,” “fixed,” “provisional,” and “final”) to which the cognizant agency may agree, depending on the organization’s circumstances. *Id.* Fixed rates and provisional rates are set in advance and later adjusted once actual costs of the rate period are known -- fixed rates through a “carryover” adjustment and provisional rates through establishment of a final rate. *Id.* A predetermined or final rate “is not subject to adjustment.” *Id.*

In addition to provisions regarding cost allocation, Appendix A to Part 230 sets out other general considerations for determining whether costs are allowable under an award, including that costs must be “reasonable for the performance of the award,” “[c]onform to any limitations or exclusions set forth in [the cost] principles or in the award as to the types or amount of cost items,” and be “adequately documented.” App. A, ¶ A.2. Appendix B contains some specific documentation requirements for specific cost items, including for personnel compensation and professional services costs, that we discuss more in detail below.

II. Case background

A. Background related to the indirect cost issues

For its fiscal years (FYs) ending on December 31, 2009 through 2012, PCA had indirect cost rate agreements it had negotiated with DCA, which is part of the federal Department of Health and Human Services (HHS), the designated cognizant agency for PCA. The

² The organization would not necessarily be able to charge all of the allocated indirect costs to the award. Some awards limit reimbursement either of indirect costs or of total administrative costs. The Head Start regulations limit costs of development and administration to 15% of the total approved costs of the program “unless the responsible HHS official grants a waiver approving a higher percentage for a specific period of time not to exceed twelve months.” 45 C.F.R. § 1301.32(a).

agreements established final rates of 22.00% for 2009, 2010, and 2011, and a final rate of 21.16% for 2012. The distribution base for each rate was described as direct salaries and wages, including vacation, holiday, sick pay and other paid absences, but excluding other fringe benefits. PCA Br. Ex. B. These rates applied to all programs, “subject to the conditions in Section III” of the agreements. Section III of each agreement contained general provisions, including the following in subsection A:

The rates in this Agreement are subject to any statutory or administrative limitations and apply to a given grant, contract or other agreement only to the extent that funds are available. Acceptance of the rates is subject to the following conditions: (1) Only costs incurred by the organization were included in its indirect cost pool as finally accepted; such costs are legal obligations of the organization and are allowable under the governing cost principles; (2) The same costs that have been treated as indirect costs are not claimed as direct costs; (3) Similar types of costs have been accorded consistent accounting treatment; and (4) The information provided by the organization which was used to establish the rates is not later found to be materially incomplete or inaccurate by the Federal Government. In such situations the rates would be subject to renegotiation at the discretion of the Federal Government.

Id.

PCA’s indirect cost rate proposal for 2009 leading to the negotiated final rate of 22.00% was based on actual costs of 2009 from PCA’s compiled functional expense statement for that year, as audited. ACF Ex. 3, at 1-2. The proposal explained that PCA “treats all costs as direct costs except for general administration and general expenses.” *Id.* With respect to indirect costs, the proposal stated:

At Piedmont Community Actions costs incurred for common objectives are our indirect costs. These costs are not readily chargeable or identified with a particular program or activity. These costs are grouped into a common pool and distributed to those programs that benefit from these activities by a cost allocation process.

Id. The proposal described the “Administrative Services Pool” as “consisting of salaries, fringe benefits, and non-salary costs” and identified the salaries charged to the cost pool by position and function (such as general management, accounting, and administrative services). *Id.* at 3, 5. The proposal described the distribution base as “direct salaries (including sick, annual, and holidays) but not other fringe benefits” and also as including

“wages” for Head Start volunteers based on HHS regulations. *Id.* at 3; *see* 45 C.F.R. § 74.23.³ The detail for how PCA computed the direct cost base identified amounts of salaries and wages for the following cost objectives: DOE (Department of Energy) Weatherization; Weatherization – ARRA (American Recovery and Reinvestment Act); Community Services Block Grant; Community Services Block Grant – ARRA; Head Start with Volunteers; Head Start Expansion – ARRA; Head Start Quality Improvement – ARRA; Early Head Start – ARRA; LIHEAP (Low-Income Home Energy Assistance Program); ABC Voucher; and Child Care Food. ACF Ex. 3, at 4; PCA Ex. H, ¶¶ 5-6. The proposal said that the “rate is equitably applied to the direct salaries of all funding sources.” ACF Ex. 3, at 4.

Based on its computations, PCA proposed an indirect cost rate of 22.55% for 2009 (.55% more than the 22% final rate approved by DCA). PCA’s Executive Director signed a DCA form submitted with the indirect cost proposal, attesting among other things that the “direct cost base is complete (i.e., [it] included all activities that benefit from the Indirect Cost Pool).” *Id.* at 7. The Executive Director also certified that “[a]ll costs included in this proposal are properly allocable to Federal agreements on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements.” *Id.* at 9.

The proposals for 2010, 2011, and 2012 were the same as the 2009 proposal in most respects, but differed from that proposal in the following ways:

- For 2010, the proposed rate was 22.06% (.06% higher than the approved final rate of 22%), and the direct cost base included salaries and wages for a “Workforce Investment Act” program, as well as the programs listed in the 2009 proposal. ACF Ex. 4.
- For 2011, the proposed rate was 22.00% (the same as the final rate), and the projects included “SC Help Mortgage” and “Head Start Mentor Coach – ARRA,” as well as the programs listed in the 2009 proposal. ACF Ex. 5.
- For 2012, the proposed rate was 21.16% (the same as the final rate), and the programs included the “SC Help Mortgage and “Head Start Mentor Coach – ARRA” projects, but did not include all of the other ARRA programs listed in the 2009 proposal. ACF Ex. 6. In addition, the 2012 proposal included more detail regarding the non-salary costs charged to the Administrative Services Pool. *Id.* at 8.

³ Below, we use the term “direct salaries” as shorthand for the distribution base as defined in the indirect cost proposals and agreements.

- For each of these three years, the Administrative Services Pool specifically included an amount for “Accrued Annual Leave for Admin Staff,” whereas the pool for 2009 either did not include the accrued annual leave or it was not separately listed.

ACF Exs. 3-6.

B. ACF’s review

From September 30 through October 3, 2013, ACF conducted an on-site monitoring review of PCA’s Head Start and Early Head Start programs through its contractor, the accounting firm Rubino & McGeehin, Chartered (Rubino). ACF Ex. 2: ACF Ex. 1 at ¶ 5. As part of its review, Rubino compared the costs from PCA’s general ledger to the costs included in PCA’s indirect cost proposals. The certified public accountant from Rubino who managed the review team reported that they “identified errors in the cost pool and in the related allocation base.” ACF Ex. 1, ¶ 7. He explained the methodology by which the review team calculated the \$109,294 disallowance of indirect costs, describing the first step as follows:

In 2009, 2010, and 2011, the indirect cost pool differed from the indirect costs recorded in PCA’s general ledger. (ACF Exhibit 7, 8, and 9, respectively.) We verified this through review of PCA’s general ledger detail reports. In each of the years in question, we identified management fees which were being paid by related parties (Piedmont Senior Housing, Plush Meadow Senior Housing and Poinsett Senior Housing) to PCA. In an interview, PCA’s Finance Manager, . . . indicated that the related party receives administrative services in exchange for management fees. Furthermore, [the Finance Manager] indicated that the indirect cost pool had not been credited with management fees received from the related party and that the cost of actual services provided to related parties had not been removed from the indirect cost pool [W]e adjusted the indirect cost pool for differences noted between the costs included in PCA’s proposals and the costs supported by PCA’s general ledger reports and the amount of the management fees which had not been offset against the indirect cost pool as required by Appendix A to Part 230, General Principles, paragraph 5(a) applicable credits. It was not possible to adjust the indirect cost pool by the administrative services rendered to related parties because PCA did not have any personnel activity reports documenting the amount of time that was spent providing administrative services to related parties.

Id., ¶¶ 8-9. The Rubino review team then made adjustments for differences they found between the amount of direct salaries in the cost proposals and the general ledger. *Id.*, ¶¶ 10-11. The team found “small differences in 2009, 2010, and 2012, but also found that PCA had understated direct salaries for 2011 by \$36,959 “because it failed to include

volunteer and substitute salaries in the base consistent with its practices in 2009, 2010, and 2012.” *Id.*, ¶ 11. The team recalculated indirect cost rates for FYs 2009 – 2012 based on the team’s adjusted direct and indirect costs. *Id.*, ¶ 12. The certified public accountant said the team “then identified direct salaries recorded by PCA for each Head Start Award in each calendar year and multiplied them by the adjusted indirect cost rates” the team had calculated. *Id.*, ¶ 13.

Rubino found that, for four ACF awards in 2009 or 2010, PCA had charged less for indirect costs than it could have charged using Rubino’s recalculated rates, but that PCA had overcharged indirect costs to five ACF awards for later periods. *Id.*, ¶ 13 (Table 4); ¶ 15 (Table 5).

Based on its calculations, Rubino recommended a disallowance of \$109,294 in indirect costs related to the five ACF awards. ACF disallowed that amount, stating it related to awards for FYs 2011 and 2012, but ACF later clarified that one award went into 2013.⁴ Rubino acknowledged during the appeal that its calculation overstated unallowable costs by \$75.61. *Id.* ¶ 29. ACF adjusted the disallowance amount accordingly. ACF Br. at 4 n. 3.

In addition, ACF determined, based on Rubino’s report, that PCA had used \$26,427.92 in supplemental Head Start funds for unauthorized purposes. Specifically, ACF found that the costs of work on a parking lot, renovation of an existing Head Start center (the ZL Madden Center), and a community assessment did not meet the restrictions ACF had placed on the supplemental award.

C. PCA’s appeal

On appeal, PCA does not deny that personnel whose salaries and fringe benefits PCA included in the Administrative Services Pools in its indirect cost proposals spent part of their time providing administrative services for which PCA received management fees. PCA identifies those services with funding the federal Department of Housing and Urban Development (HUD) awarded under its “Section 202” program to the three PCA subsidiaries, Piedmont Senior Housing, Plush Meadow Senior Housing, and Poinsett House Senior Housing. PCA Br. at 3, 5. PCA argues that it properly treated all of the

⁴ ACF’s brief identified the five awards related to the disallowance as follows: Award No. 04CH4012/41 (budget year June 1, 2010-May 31, 2011); Award No. 04CH4012/42 (budget period June 1, 2011-May 31, 2012); Award No. 04CH4012/43 (budget period June 1, 2012-May 31, 2013; Award No. 04SA4012/02 (budget period September 30, 2010-September 29, 2011); and Award No. 04SH4012/02 (budget period September 30, 2010-September 29, 2011). ACF Br. at 4 n.3. For the part of the budget period for Award No. 04CH4012/43 in 2013, Rubino used the 22% provisional rate for 2013, offsetting an underpayment for that part of the award period against an overpayment it calculated for the part of the budget period in 2012. ACF Ex. 1, ¶ 15.

administrative services costs as indirect costs and that ACF had no authority to recalculate the rates, which were final. Alternatively, PCA offers calculations based on time studies allocating time of administrative staff among the HUD projects and other activities and on revised indirect cost rates calculated by a certified public accounting firm hired by PCA. Under this alternative analysis, however, PCA argues that at most \$22,579.96 in indirect costs was improperly charged to ACF funds.

With respect to the direct costs charged to its supplemental award, PCA does not deny that the costs of paving the parking lot and renovating the ZL Madden Center were not allowable charges to the supplemental award. PCA argues, however, that the \$5,000 for the community assessment was allowable and that PCA incurred \$11,700 in costs of architectural fees, not previously reported, that should substitute for the unallowable costs charged to the supplemental award.

PCA argues that the maximum amount by which PCA overcharged Head Start and Early Head Start awards is \$32,304.96 (\$22,579.96 for indirect costs and \$9,725 for direct costs) – an amount PCA refunded to ACF.

III. Analysis

Below, we first discuss the issues PCA raises with respect to the disallowance of indirect costs. We explain why we reject some of PCA's arguments, but remand the disallowance of indirect costs for further consideration by DCA and ACF, consistent with our analysis below. We then address PCA's arguments regarding the direct costs disallowed under the supplemental award and the architectural fees PCA seeks to substitute for the disallowed costs. We explain why we uphold the disallowance of \$26,427.92 in direct costs charged to supplemental Head Start funds.

A. We remand the indirect cost issues for further consideration.

- 1. PCA failed to justify including the costs of administrative services provided to related organizations in the Administrative Services Pools used to calculate the indirect cost rates without including the direct costs of the related organizations in the base.*

To justify including the questioned costs in the Administrative Services Pool, PCA argues that certain provisions of the cost principles “treat related parties and the recipient as a single entity.” PCA Br. at 3. PCA also argues that its administrative services costs were indirect rather than direct costs because they were incurred for common or joint objectives and could not be readily identified with a particular final cost objective. *Id.* PCA points out that it “generally treats administrative services as an indirect cost” and

that the cost principles state that a “cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.” *Id.*

These arguments have no merit. PCA admits that it did not include any direct salaries from the HUD projects in the distribution bases in its indirect cost proposals. PCA Supp. Br. at 2. This is also evident from PCA’s cost proposals. ACF Exs. 3-6. The HUD Senior Housing projects for which PCA received management fees were not among the projects listed in the indirect cost proposals whose direct salaries were used to calculate the rates and to distribute the indirect costs, despite the fact that those HUD projects benefitted from the administrative services PCA provided. Thus, contrary to what PCA’s Executive Director had attested in each rate proposal, the direct cost base was not “complete”; that is, PCA had not included in the direct cost base all activities that benefitted from the costs in the indirect cost pool. Moreover, PCA was not using the resulting rates to distribute the costs among all of its funding sources.

Had the direct salaries of the HUD projects been included in the distribution base each year, then this would have resulted in a lower indirect cost rate and in allocating indirect costs to the HUD projects. By including the costs of the administrative services provided to the HUD projects in the Administrative Services Pool (the numerator of the ratio used to determine the rate), without including any direct costs of those projects in the distribution base (the denominator used to determine the rate), PCA violated the cost principles. Those administrative services were not incurred for common or joint objectives of the projects to which they would be distributed by use of the rate (that is, only the non-HUD projects listed in the proposal). Nor were the costs of providing services to the HUD projects necessary to the overall operation of PCA as an organization. In other words, there was no causal or other beneficial relationship between the expenses incurred for administrative services for the HUD projects and the cost objectives to which those costs would be allocated by applying the indirect cost rates to the direct cost base.

Under the cost principles, the method used for allocating indirect costs must be an equitable one that reasonably can be considered as distributing costs according to the relative benefits received by each cost objective. Yet, by including the HUD-related costs in the Administrative Services Pool each year, PCA obtained a higher indirect cost rate than if those costs had been excluded from the Administrative Services Pool. Moreover, applying those inflated rates to the direct salaries of the non-HUD projects in the distribution base would result in the costs of administrative services for the HUD projects being allocated among non-HUD projects, including Head Start, and could result in PCA receiving duplicate payments for the services – once through the management

fees and once through charges to its non-HUD projects. *See Economic Opportunity Corp. of Greater St. Joseph*, DAB No. 45 (1978) (denying grantee request to include and charge as indirect costs amounts for administrative costs already funded directly because that would result in the grantee being paid twice for the same costs).

PCA suggests that, because it generally treats the costs of the administrative services as indirect costs, it needed to include all of those costs in the Administrative Services Pool to comply with the requirements for consistent treatment of costs. But PCA should have recognized that it was inconsistent to charge management fees for the administrative services benefiting the HUD projects (therefore treating them like direct costs), rather than applying an indirect cost rate to the direct cost base for those projects to determine what to charge to those projects, as it did for other projects. Also, the consistency required in treating costs as direct or indirect applies where there are “like circumstances.” Yet, the circumstances of the HUD projects were different from the circumstances of the non-HUD projects for which the awards were made to PCA, not to a subsidiary.

PCA’s reliance on the fact that the subsidiaries were related parties is misplaced. The cost principles do provide for treating a recipient of federal funds and a related party as a single entity in the case of transactions that could be used to inflate charges to federal funds if the parties are not treated as one entity.⁵ Contrary to what PCA asserts, however, this does not mean that the cost principles treat a recipient and a related party as a single entity for every purpose; nor did PCA treat itself and the related parties as part of a single entity for every purpose. As noted above, PCA included the direct salaries of the non-HUD projects in the distribution bases in its indirect cost proposals, but PCA admits that it did not include any direct salaries from the HUD projects in the distribution bases. PCA Supp. Br. at 2. PCA says this is because PCA “does not pay any subsidiary salaries.” *Id.* These admissions show, however, that PCA did not treat the related parties and PCA as a single entity for every purpose.

PCA also argues that ACF erred by treating the management fees as “applicable credits.” ACF determined that PCA’s receipt of the management fees constituted a transaction that “operate[d] to offset or reduce expense items that are allocable to awards as direct or indirect costs” and should be applied “[t]o the extent that such credits accruing or received by the organization relate to allowable cost,” quoting from paragraph A.5.a. of

⁵ Thus, for example, paragraph 43 of Appendix B to Part 230 (which PCA cites in support of its argument) limits the amount a recipient may charge to federal funds for use of space in a building owned by a related party to the amount that could have been charged if the recipient owned the building. Otherwise a recipient could transfer building ownership to the related party and then charge federal funds for rent paid to the related party in excess of what the recipient could have charged had it retained ownership, even though the recipient is essentially paying itself and incurring no new costs for the space.

Part 230, Appendix A. ACF Determination at 2; ACF Br. at 7. PCA says that treating the management fees as applicable credits under this definition is inconsistent with ACF's position that the administrative services costs for the HUD projects were not allowable and allocable costs of PCA's Head Start and Early Head Start awards. While there may be some merit to this argument, it is equally true that PCA is inconsistent in seeking to characterize the costs of administrative services provided to the HUD projects as allowable costs that were allocable to the non-HUD projects, without treating the management fees as transactions that offset those costs.

Moreover, contrary to what PCA suggests, the definition of "applicable credits" is not limited to the type of transaction identified in paragraph A.5.a. and illustrated by the examples in that paragraph. Paragraph A.5.b. provides that, in some instances, amounts received from the federal government to finance organizational activities or services should be treated as credits. "Specifically," paragraph A.5.b. goes on to say, "the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds." Here, federal funds in the form of HUD management fees directly financed, in part, the resources used in providing the general administrative services.

In any event, regardless of whether ACF correctly treated the management fees as applicable credits, ACF is clearly correct that PCA's proposed indirect cost rates were overstated because PCA included costs that benefitted the HUD projects in the indirect cost pools but did not include the direct salaries of those HUD projects in the distribution bases.

2. *The cost principles regarding final rates do not preclude the federal government from taking action to correct the effect of PCA's mistake.*

PCA argues that the Board should "reverse the disallowance because approved negotiated indirect cost rates were in place for all fiscal years from 2009 through 2012." PCA Br. at 4. PCA points out that the cost principles state that a "final rate is not subject to adjustment." *Id.* PCA notes that ACF's disallowance letter did not provide any authority that permits ACF to recalculate a final negotiated indirect cost rate. *Id.*⁶

⁶ PCA also argues that ACF's disallowance notice was inadequate because it did not explain how ACF calculated the disallowed indirect costs. PCA Br. at 2. PCA understood the issues sufficiently to provide its own calculations, however, and has had ample opportunity to comment on ACF's calculations during Board proceedings.

PCA's reliance on the "no adjustment" provision in Part 230, Appendix A, is misplaced to the extent that PCA would have us interpret that provision as precluding the federal government from taking any action to adjust final rates upon discovering a material error in the information that led to a final rate. In context, the "no adjustment" provision is simply meant to distinguish between provisional and fixed rates, which are subject to adjustment once actual costs for the rate period are known, and predetermined and final rates, which are not subject to adjustment based on the difference between the historical costs used to calculate the rate and later-determined actual costs of the rate period. 2 C.F.R. Part 230, App. A, ¶ E.⁷

The cost principles contemplate that an indirect cost proposal will lead to a written negotiation agreement. As pointed out above, while the negotiated agreements between DCA and PCA established final rates for the years at issue, those rates were specifically made subject to the conditions in Section III of the agreements, quoted above. Each agreement included the condition that, if the information provided by the organization which was used to establish a rate was materially incomplete or inaccurate, the rate would be subject to renegotiation at the discretion of the federal government. PCA's Executive Director signed each of the agreements, so PCA cannot reasonably claim that it was unaware that DCA did not read the cost principles as requiring the federal government to apply the negotiated final rates no matter what information was later discovered about those rates.

On the other hand, the rate agreements at issue here provide for a discretionary decision "by the Federal Government" about whether to **renegotiate** the rates, and do so only if the information was "materially" incomplete or inaccurate. These agreements do not contain any provision for one program agency to unilaterally recalculate the rates. Within HHS, moreover, DCA is the component whose records would show what information was, in fact, used in establishing the rates and whether the information disclosed during negotiations was materially incomplete.⁸ Here, PCA neither disclosed in its indirect cost proposals that it received management fees from the related parties nor claimed that it otherwise disclosed the fees during the negotiations, so it appears likely

⁷ We do not decide here whether ACF could ever legally adjust a final indirect cost rate unilaterally for the purpose of determining the amount of an otherwise appropriate disallowance.

⁸ The Board has discussed the role of DCA in several cases. *E.g., The Johns Hopkins University*, DAB No. 1393 (1993) (Where DCA's records showed that a general reduction was negotiated to account for any unallowable costs included in an indirect cost pool, the Board found that no refund was required merely because specific unallowable costs were later identified.); *Campesinos Unidos, Inc.*, DAB 1546 (1995) (Where ACF had pointed out that "DCA's role was in the negotiation of indirect cost rates," the Board directed ACF to "consult with DCA [on remand] concerning the extent to which Workman's Compensation costs [for which the grantee had received refunds] were included in [the grantee's] indirect cost proposals and what effect, if any, this had on [the grantee's] indirect cost rates").

that the information used to establish the rates was incomplete. It also appears likely that information about the management fees was material to the rate calculations since the fees (\$56,154 for FYs 2009 and 2010 and \$66,667 for FYs 2011 and 2012) were equal to roughly eight to ten percent of the total indirect cost pools proposed each year. ACF Ex. 1, ¶ 7 (Table 1).

Yet, we cannot definitively decide here whether the information used to establish the rates was materially incomplete. ACF does not claim it consulted with DCA regarding what its records show about what PCA disclosed during the negotiations or whether DCA would consider omission of information about the management fees to be a material omission that would cause DCA to renegotiate the rates. As discussed above, moreover, the cost proposals identified other, non-ACF federal projects as being included in the direct cost base used to distribute the indirect costs. DCA may wish to consult with federal program agencies in addition to ACF and to consider factors such as any identified under-recovery of indirect costs in 2009 and 2010 in deciding whether to renegotiate the rates.

In any event, we have determined that remand of the indirect cost issues is required and would benefit from input by DCA for other reasons. To support its calculations, PCA offered revised indirect cost proposals from its consultant accounting firm, which purport to have removed from the indirect cost pools the alleged actual costs of the administrative services for the HUD projects (determined by use of “time studies” of administrative staff time). PCA also provided its own calculations of under- and over-recoveries of indirect costs for various years under ACF’s projects. ACF relied on an analysis of PCA’s calculations by Rubino’s lead accountant and on Rubino’s original calculations (with the one minor adjustment that reduced the disallowance amount by \$75.61). We have concluded that a disallowance in some amount is likely justified. Were we to decide on the record before us the amount of any such disallowance, we likely would resolve some of the computational disputes in favor of each party, but we have also identified flaws with each party’s proposed calculations that would preclude resolving all of these disputes. Although the Board several times asked the parties questions intended to develop the record and provided extra opportunities for the parties to submit information, the parties still have not provided sufficient information to allow us to resolve all of the issues raised regarding the rates and any resulting disallowance amount.

Below, we next discuss why we conclude that PCA’s documentation is inadequate to show that the actual costs of the administrative services provided to the HUD projects were less than the management fees received. We then discuss why PCA may not offset total under-recoveries of indirect costs in FYs 2009 and 2010 from its ACF awards against total over-recoveries of indirect costs under ACF awards for later years. We then identify other problems we have found with each party’s indirect cost calculations that make them unreliable.

3. *PCA did not meet its burden to show that the actual costs of the administrative services provided to the HUD projects were less than the management fees.*

PCA's calculations reduced the Administrative Services Pools for each year by an amount it said represented the actual costs of the administrative services provided to the HUD projects, rather than reducing the cost pools by the amount of the management fees it received each year, as Rubino did. Rubino appeared to recognize that removing the actual costs of administrative services provided to HUD projects from an indirect cost pool in recalculating a rate might be preferable to using the management fees as a proxy for actual costs. Rubino found, however, that PCA had not maintained personnel activity reports showing how PCA's administrative staff spent its time. ACF Ex. 1, ¶ 9. As ACF points out, the cost principle addressing personnel compensation at Part 230, Appendix B, paragraph 8.m. requires that the "distribution of salaries and wages to awards must be supported by personnel activity reports, as prescribed in subparagraph 8.m.(2) of this appendix, except when a substitute system has been approved in writing by the cognizant agency." Paragraph m.(2) provides:

Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. . . . Reports maintained by non-profit organizations to satisfy these requirements must meet the following standards:

- (a) The reports must reflect an after-the-fact determination of the actual activity of each employee. . . .
- (b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.
- (c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.
- (d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

The documents on which PCA relies to allocate the time of its administrative staff do not meet these requirements.

PCA acknowledges that the time studies its accounting firm used to recalculate the rates were prepared in 2013, in response to the audit rather than contemporaneously with the time and effort studied. PCA Supp. Br. at 1; ACF Ex. 13. Moreover, PCA submitted only "Time Study Worksheets" for each year describing the general nature of the tasks

performed by each administrative employee and allocating the employee's hours (with corresponding percentages) among the following categories: "Administrative," "OEO Programs," "DHHS Programs," and "Senior Housing." PCA Ex. C. The worksheets are not signed by any employee or supervisor.

Generally, where a grantee has not maintained contemporaneous records documenting time and effort consistent with the cost principles or obtained approval for a substitute system, the Board will not accept a grantee's evidence about how its employees spent their time, absent strong indicia of reliability. *Philadelphia Parent Child Ctr., Inc.*, DAB No. 2297, at 6 (2009); *Norwalk Economic Opportunity Now, Inc.*, DAB No. 2543, at 9 (2013). We do not find such indicia of reliability here. PCA says that, although it prepared the time studies in 2013, they were based on an analysis of time spent during the period 2009 through 2012. PCA Supp. Br. at 3. Yet, PCA provided no information about who performed the analysis or how they did it, much less any evidence that whoever did the analysis had first-hand knowledge of the time actually spent by the administrative staff on various activities during the relevant period.

PCA argues that the requirement for personnel activity reports does not apply here, because the compensation was not being charged either directly to awards or partially to direct activities and partially to indirect activities. *Id.* Instead, PCA asserts, it uniformly treats compensation for personnel performing administrative activities as an indirect cost to be allocated using its indirect cost rate. *Id.* at 3-4. As discussed above, however, PCA was including the costs of services provided to the HUD projects in a cost pool that was allocated only to non-HUD projects through use of the rates, and PCA has not identified any direct salary base for the HUD projects that could be used to recalculate the rates and to allocate the costs to the HUD projects. PCA asserts that the revised rates its accounting firm calculated are more accurate than the rates calculated by Rubino because PCA's accounting firm reduced the indirect cost pools by amounts PCA says represent the actual costs allocable to the HUD projects. PCA clearly had a burden to support this assertion with adequate evidence. PCA did not meet this burden because it did not have the type of contemporaneous documentation usually required to distribute staff time and has not established that its 2013 time studies are reliable.

We also note that PCA's accounting firm adjusted the Administrative Services Pools downward only for labor costs (salaries and fringe benefits) in its revised indirect cost proposals for 2009 and 2010. In the revised proposals for 2011 and 2012, the accountants also adjusted the indirect costs downward for vehicle maintenance & fuel and for depreciation to account for "personal usage of auto and portion allocated to [management] fees." *See* Schedule C of revised proposals included with Notice of Appeal. The accountants provided no explanation about why they made no downward adjustment to other indirect, non-labor costs such as communications and utilities that might have been generated by the administrative services provided to the HUD projects and covered by the management fees.

The Board asked PCA to provide a copy of its contracts with the related parties for the management fees in order to determine what costs those fees were intended to cover. In response, PCA submitted documentation and an affidavit indicating that the management fees were a percentage of the rent collected each month by each of the subsidiaries, for the apartment complexes they own. PCA Exs. F-H. PCA acts as the management agent for the projects based on Management Certifications submitted to HUD by the subsidiaries and approved by HUD. PCA Ex. H (Fiscal Manager's Decl.), ¶ 9. Under the Management Certifications, PCA "earns a management fee for providing general management and administrative support services." *Id.*, ¶ 10. This description is very vague and does not explain why PCA's accounting firm would allocate only some vehicle related costs to the HUD projects and not any of the other non-labor costs of general administration.

Thus, we conclude that PCA did not meet its burden to show that its calculation of the costs of the administrative services provided to the HUD projects is a more accurate estimate of those costs than the amount of the management fees it received for those services.

4. *PCA's calculation of the maximum amount owed to ACF improperly offset total under-recoveries against total over-recoveries.*

The analysis PCA used to calculate the maximum amount PCA says it owes for indirect costs charged to ACF projects is by its fiscal year (which is the same as the calendar year and is the period covered by each indirect cost rate) and by ACF project. The individual grant awards at issue, however, had budget periods (which ACF also refers to as program years) that spanned more than one year. PCA's calculation of the amount due to ACF offset the total alleged "under-recoveries" of indirect costs from the earlier years against the total "over-recoveries" it calculated for later years. As ACF points out, offset of under-recoveries against over-recoveries of indirect costs is appropriate only on an individual award basis and only if sufficient funds remain in a particular award to permit further recovery of indirect costs. ACF Br. at 11; *Seminole Nation of Oklahoma*, DAB No. 1385 (1993); *Central Piedmont Action Council, Inc.*, DAB No. 1916 (2004); *Motivation Education & Training, Inc.*, DAB No. 2548 (2012). Each award has its own terms and conditions and its own funding limits, such as the Head Start limit on recovery of administrative costs we cite in note 2 above. Moreover, each award specifies a funding period, and a recipient may charge to an award only allowable costs arising from obligations incurred during that funding period. 45 C.F.R. § 74.28.

According to Rubino's lead accountant, none of the four individual ACF awards for which Rubino identified under-recovered indirect costs had funds remaining that could be used to cover additional indirect costs. ACF Ex. 1, ¶ 23; ACF Ex. 2, at 3.⁹ PCA did not dispute this assertion or provide any information regarding unexpended funds from any of the relevant awards.

Thus, we conclude that no offset of under-recoveries against over-recoveries of indirect costs is appropriate.

5. We have also identified other flaws in PCA's calculations.

We have also identified other flaws in PCA's calculations. Rather than applying the revised rates PCA's accounting firm calculated for each year to the direct cost bases of each Head Start or Early Head Start award from that year, PCA used its accountants' revised rate for 2009 (20.92%) to calculate allowable indirect costs for its ACF awards for all of the years 2009 through 2012. The revised rates PCA's accounting firm calculated for the three later years were lower than the 2009 rate – 20.56%, 20.42%, and 19.58%, respectively. ACF Ex. 1, ¶¶ 18, 19. Thus, PCA's calculations were clearly flawed.

PCA's calculations also did not include volunteer and substitute salaries in any distribution base, either for the purpose of determining the rates or for purposes of distributing/allocating costs to the ACF awards. Including them in the distribution base/denominator for purposes of determining the rates would have lowered the rates. On the other hand, adding those costs to the direct cost base used to determine what part of the indirect costs was allocable to PCA's basic/regular Head Start award would have increased the proportion of indirect costs allocable to that award. Thus, this failure affected both the rate calculations and the calculation of under- and over-recoveries of ACF funds.¹⁰

We note that, in the follow-up report in which Rubino analyzed PCA's revised calculations, Rubino suggested that ACF could exclude in-kind salaries and wages from the direct cost base and therefore increase the disallowance amount. ACF Ex. 11.

⁹ We also note that the disallowance of funds under the basic Head Start project (#04CH4012) that included supplemental funds for budget period 40 (June 1, 2009 through May 31, 2010) would not free up funds for unrecovered indirect costs. As discussed below, that disallowance pertains to supplemental funds that were awarded for only specific, restricted cost items.

¹⁰ We also note that PCA's calculations included an over-recovery of indirect costs in 2011 and 2012 from awards for its Head Start Mentor Coach - ARRA project (#04SE4012). ACF Ex. 1, ¶ 18 (Table 6). ACF's determination did not, however, disallow any indirect costs under that award. (See note 4 above listing the awards for which ACF disallowed indirect costs.)

Rubino sought to justify this increase on the basis that authority for PCA's rates had been transferred to the DCA office in Dallas, Texas, which treats such costs differently from the DCA office in Washington, D.C. that negotiated the rates with PCA. *Id.* DCA had apparently agreed to a base described as including such costs, however, and Rubino does not assert that including the costs resulted in any inequity to the federal government. The issue for determining what costs to include in a base is whether they relate to activities that generate indirect costs, and the DCA office in D.C. could reasonably determine that some general administrative expenses were generated by the volunteers and substitutes. Apparently, ACF agrees. ACF did not increase the disallowance amount, as Rubino's report had suggested.

6. *In addition to the minor calculation error Rubino identified during the appeal, we have other questions about Rubino's calculations.*

In addition to the minor calculation error Rubino itself identified during the appeal process, there appears to be another obvious mathematical error. Specifically, Rubino found that total direct salaries recorded in the general ledger were \$26 less than the \$2,520,341 in total direct salaries per PCA's cost proposal for FY 2009, but instead of adjusting the direct cost base for that year to \$2,520,315 (\$2,520,341 - \$26), Rubino adjusted the base to \$2,519,515 (which is \$826 less than \$2,250,341). ACF Ex. 2, at 6; ACF Ex. 1, at ¶ 10.

More importantly, Rubino's calculations used amounts from PCA's general ledgers, apparently assuming they were more accurate than the amounts in the indirect cost proposals. The proposals were based on the audited financial statements, however. Nothing in the affidavit of Rubino's lead accountant for the ACF review or in ACF's briefs explains any basis for assuming that the general ledger amounts here are more accurate than the audited amounts. Absent such a reason, we find that PCA properly used the amounts from the audited financial statements, rather than its general ledger, in its indirect cost proposals.¹¹

Whether because Rubino used the general ledger amounts rather than the audited financial statements or for other reasons, Rubino's calculations used some numbers that differ from PCA's numbers but were not adequately explained in either Rubino's initial report or in its analysis of PCA's calculations. Examples of such discrepancies in the amounts for indirect costs charged to the various projects for each year include the following:

¹¹ We recognize that resorting to the general ledger amounts to identify direct costs of particular awards for a specific fiscal year might be necessary if the audited financial statements do not report the direct costs of individual awards separately. See *Motivation Education & Training, Inc.*, supra at 8-10. Here, however, Rubino substituted general ledger amounts for total amounts reported on the audited financial statements for the rate years without an adequate explanation for why that substitution would be appropriate.

- For PCA’s basic Head Start project #04CH4012 (which PCA’s calculations refer to as “HS Reg” and which the indirect cost proposals refer to as “Head Start with volunteers”), Rubino identified as the amounts of indirect costs charged to the awards in 2011 a total of \$435,250.78 (\$184,389.48 in budget period 41 plus \$250,861.30 in budget period 42). PCA identified a total of \$394,308 in indirect costs for 2011 charged to the “HS Reg” project “Per Audit.” ACF Ex. 1, ¶¶ 15 (Table 5), 18 (Table 6).
- The total for 2012 that Rubino identifies as indirect costs charged to this project is \$542,077.70, compared to the \$371,242 that PCA identified as having been charged to this project “per audit” for 2012. *Id.*
- For the Head Start Expansion project (#04SH4012), Rubino’s breakdown by grant award in response to PCA’s calculations allocated \$8,644 in indirect costs as charged to that award for the 01 budget period, but Rubino originally used \$8,803.35 as the amount of indirect costs charged to the Head Start Expansion project for that budget period. *Id.*, ¶¶ 22 (Table 8), 13 (Table 3).

There also appear to be differences between the amounts Rubino used as the direct cost base for several ACF projects, compared to the amounts PCA used. For example, for 2011, Rubino used \$2,072,019 (\$859,148 from budget period 41 and \$1,212,870.72 from budget period 42) as the direct cost base for PCA’s basic Head Start project (#04CH4012). ACF Ex. 1, ¶ 15 (Table 5); ACF Ex. 2, at 2, 4. PCA’s indirect cost proposal for that year had identified \$1,834,007 as direct salaries for that project per audit. ACF Ex. 5, at 5. Rubino found that PCA’s indirect cost proposal **understated** total direct salaries in that year by \$36,959 because PCA had failed to include volunteer and substitute salaries in the base, as it did in other years. ACF Ex. 1, ¶ 11. But that alone does not explain the full \$238,012.53 difference between the total amount used by Rubino and the total reported by PCA in its proposal as the amount of direct salaries for 2011 for that project.

The record is also unclear about whether PCA reported any indirect costs as part of its non-federal share and, if so, whether Rubino’s calculations included those indirect costs in the disallowance amount. Generally, the non-federal share for a Head Start grantee is 20% of the total costs of the program. 45 C.F.R. § 1301.20. If PCA met its non-federal share requirement for an award without having to count any indirect costs as part of its non-federal share, disallowance of indirect costs claimed as non-federal share would not be appropriate.

On the other hand, if PCA had claimed some indirect costs as part of its non-federal share, that may be why the amount it charged to federal funds was less than its approved rates would have allowed for some budget periods. Even if additional funds were

available under an award, PCA could not legally receive any federal funds for indirect costs that PCA needed to cover with its own funds in order to meet its non-federal share requirement.

It is also possible that if PCA did not charge indirect costs at its full approved rate for an award, the reason was that it was precluded from recovering the full amount because of the Head Start limit on administrative costs. Neither party addressed whether that limit had any effect on the amounts at issue, however.

In sum, we have determined that the errors and uncertainties about the indirect cost calculations can best be resolved by a remand of this case, so that (1) DCA can decide whether to renegotiate the rates for some or all of the years in question, and (2) if revised rates are negotiated for any period, ACF can recalculate the amount, if any, of unallowable indirect costs charged to its awards, consistent with our analysis above.

B. We uphold ACF's disallowance of the direct costs charged to PCA's supplemental award.

PCA conceded that the costs of paving the parking lot (\$12,500) and renovating the ZL Madden Center (\$8,925) were not allowable charges to the supplemental award. PCA argues, however, that the \$5,000 for the community assessment was allowable because the purpose of the assessment was to determine where PCA should relocate its Head Start Center. PCA also alleged that it incurred \$11,700 in costs for architectural fees, not previously reported, that should substitute for the unallowable costs charged to the supplemental award.

The supplemental award document for the budget period June 1, 2009 through May 31, 2010 awarded \$261,250 in the budget category for Facilities/Construction, saying that the costs under that line item "are to be used as described in the grantee's application for the following: Facility Purchase Amount 261250 (sic); Major Renovation Amount 0; and Construction Amount 0." ACF Ex. 11, at 1-2. The award notice also said:

This award reflects a one time supplement for Program Improvement to be used as follows: \$261,250 to be used for the construction/renovation of building to replace current ZL Madden Head Start facility. These funds are 25% of the total estimated cost of the project.

Id. at 2. The funds could not be used for any other purpose without written approval from the ACF Regional Office. *Id.* The two descriptions in the award notice are somewhat confusing since the first description states that all of the funds were to be used for purchasing a facility and none of the funds were to be used to do major renovations or to construct a facility whereas the second description states that all of the funds were to

be used for “construction/renovation” Although we do not have the funding application in the record, according to Rubino’s report, PCA proposed to use the funds to acquire a particular facility, but instead acquired a different facility, charging costs for that facility to the supplemental award without ACF prior approval. ACF Ex. 2, at 5.

ACF did not disallow all of the costs that PCA charged to the supplemental award and that Rubino questioned. ACF says, however, that the community assessment which PCA claims was done in connection with the facility purchase is not allowable as a charge to the supplemental funds because it is outside of the purposes for which the supplemental funds were awarded. ACF also points out that Head Start grantees are required, as part of the basic program, to do a community assessment that includes assessing where to locate Head Start centers. ACF Br. at 12, citing 45 C.F.R. § 1305.3. PCA does not deny this, but argues that “a similar but not identical analysis” is required in connection with construction and renovation awards, citing 45 C.F.R. 1309.10(a). PCA Reply Br. at 10. The section PCA cites, however, refers to information about the appropriateness of a facility location that must be included with an application for funding for the purchase, construction, or major renovation of a facility, thus implying that the grantee should have already obtained such information before even applying for such funds. PCA did not provide any evidence based on which we could determine that its application for supplemental funding proposed to use part of the supplemental funds for an assessment of where a new center should be located or that ACF granted any part of the supplemental funds for that use. Indeed, PCA does not deny that its application indicated that PCA had already identified a facility for purchase when it applied for the supplemental funds. Thus, we find that conducting the community assessment was not within the authorized purposes for the supplemental funds and uphold the disallowance of the \$5,000 for the community assessment.

With respect to the architectural fees, ACF says that the supporting documentation is insufficient to meet the requirements for professional fees in Part 230, Appendix B, section 37. Under paragraph a. of that that cost principle, costs of professional services rendered by persons who are members of a particular profession or possess a special skill may be allowable, subject to paragraphs b. and c., “when reasonable in relation to the services rendered, not contingent upon recovery of the costs from the Federal Government,” and not provided by officers or employees of the non-profit organization. Paragraph b. lists relevant factors in determining allowability, including the qualifications of the individual or concern rendering the service and the customary fees charged for non-federal work, and the “[a]dequacy of the contractual agreement for the service (*e.g.*, description of the service, estimate of time required, rate of compensation, and termination provisions).” Paragraph c. provides that “retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.”

The invoices PCA submitted are from an architectural firm and indicate that they were for “PCA Head Start Education Facility Renovation” and included \$10,000 as a “Phase 1 Fixed Fee” for services performed from March 26, 2010 to July 25, 2010 and \$1,770 for 20 hours for “Alternate Services – Field Survey” performed in the period June 26 to July 25, 2010. Documents attached to Notice of Appeal. The invoices specify the actual personnel who provided services, their hourly rates (\$85 and \$95), and the hours worked only for the field survey. The architectural firm’s proposal described the project as the “renovation of an existing one story 25,000 SF building previously owned and occupied by Bi-LO” that would enable PCA to “relocate their current head start program and their proposed early head start program into an existing structure.” PCA Ex. J, at 1st page. Phase I was described as including the following:

- “Programming session to qualify the functional needs, special relationships and sizes of desired spaces for the proposed office.”
- “Provide a Schematic Site Plan and Floor Plan for review and approval based on program documentation and client input.”
- “Provide a schematic level cost estimate.”

Id. at 2d page. The description of Phase I also stated: “As we currently do not have any drawings of the existing building, we will plan on field measuring and documenting the existing building. This work will be provided as an alternate service listed.” *Id.* Under “Alternate Services” the proposal said: “Field survey and document existing building: **\$4,000** to be billed hourly on a not to exceed basis.” Proposal attached to Notice of Appeal (emphasis in original). A listing of the hourly rates for personnel by title was included with the proposal and was described as a schedule of the “standard hourly rates” charged for various staff of the architectural firm in calendar year 2010. The proposal estimated that Phase I would take three to four weeks, but did not identify which specific personnel would work on that phase or estimate how much time of any specific profession would be required. PCA’s Executive Director accepted the proposal on March 15, 2010.

In reply to ACF’s assertion that PCA had not provided a copy of the contract referred to in the architectural firm’s proposal, PCA submitted a copy of the contract between it and the architectural firm, signed on May 13, 2010. PCA Ex. I. Article 9 of the contract contains a clause permitting PCA to terminate the contract. *Id.* at 14. The contract is based on a standard form agreement from the American Institute of Architects, but contains additions and deletions (as shown by vertical lines on the left side of the agreement indicating revisions made by the contract’s author). *Id.* at 1. Among the revisions or additions are the amount of and basis for compensation, which indicates only that the Architect’s Basic Services will be compensated at \$10,000 for Phase I and at 7.0% of construction cost for Phase II. *Id.* at 15.

The documents appear to tie the architectural firm's services to the newly acquired building and to address some of the requirements for professional fees. ACF does not deny PCA's assertion in its reply brief that "the plans developed by the architectural firm were submitted to and approved by the Office of Head Start and used for the replacement center." PCA Reply Br. at 11. We nonetheless find the documents inadequate to show that the fees PCA paid were reasonable for the services performed, for the following reasons:

- The documents show that PCA paid increments of the fixed \$10,000 fee based on the percentage of Phase I completed, rather than reimbursing the architectural firm based on the professional services actually rendered.
- The documents submitted identify the hours worked only for the staff who did the field survey, and PCA submitted no record showing the qualifications of those staff members or any information about who did any other work on the project.
- While the rate schedule identifies "standard" rates for individuals with various qualifications, we have no way of relating that schedule to the amounts the architecture firm charged and was paid.

ACF also argues that the documents are insufficient to show that PCA may substitute the architectural fees for the disallowed costs because PCA did not show that it used its own funds to cover the costs. In reply, PCA's Fiscal Manager attested that the checks made out to the architecture firm that PCA had previously submitted "were drawn on Piedmont's general operating fund at Wachovia Bank" PCA Ex. H, ¶ 13. He did not, however, identify the source of the funds that went into that account.

In addition, the Board asked PCA whether PCA had used the architectural fees to meet its non-federal share requirement under the award. Acknowledgment Ltr. at 6. PCA did not respond to this question. Thus, we cannot rule out the possibility that substituting the fees for the disallowed costs (thus effectively charging the fees to federal funds) would mean that PCA could not meet its non-federal share requirement.

Thus, we uphold the disallowance of the \$26,427.92 in direct costs that PCA charged to its supplemental award, and conclude that PCA may not offset the architectural fees against the unallowable costs.

IV. Conclusion

For the reasons stated above, we remand the issues related to indirect costs. On remand, ACF should consult with DCA to determine whether DCA will renegotiate the final rates for the periods at issue. If the rates are renegotiated, ACF may then apply those rates to determine the amount of excess indirect costs, if any, actually charged to ACF's awards and disallow those costs. Our decision does not preclude ACF and PCA from informally resolving their dispute about any excess indirect costs charged to ACF awards.

We uphold the disallowance of \$26,427.92 in direct costs that PCA charged to its supplemental award. We note that PCA has already repaid this amount, plus an additional \$5,877.04. This repayment should be taken into account in any future determination.

_____/s/
Sheila Ann Hegy

_____/s/
Leslie A. Sussan

_____/s/
Judith A. Ballard
Presiding Board Member