Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

William Smith, Sr. Tri-County Child Development Council, Inc.
Docket No. A-15-44
Decision No. 2647
June 30, 2015

DECISION

William Smith, Sr. Tri-County Child Development Council, Inc. (the Council), a nonprofit corporation, operates Head Start and Early Head Start programs in Texas. These programs are financed with grants issued by the Administration for Children and Families (ACF) under the federal Head Start Act, 42 U.S.C. § 9831, *et seq.*

Based on information obtained from an audit and subsequent onsite visit, ACF disallowed the Council's expenditure of $1,369,286.11 in Head Start grant funds. The Council appeals a portion of the disallowance but has not rebutted ACF's findings that the disputed expenditures violated the terms and conditions of its Head Start grants. We therefore affirm the disallowance. In addition, we decline to review certain findings by ACF that were not the basis for the disallowance.

Legal Background

The recipient of a federal Head Start grant 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. In turn, the Part 74 regulations require the recipient of a federal "award" (a

[1] Effective December 26, 2014, Part 74 of Title 45 of the Code of Federal Regulations was superseded by the "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for HHS Awards" published in 45 C.F.R. Part 75.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. 57,871, 57,889 (Dec. 19, 2014). We cite to the Part 74 regulations because they were in effect when the Head Start grants implicated by the disallowance were issued. *Central Ala. Comp. Health, Inc.*, DAB No. 2625, at 2 n.3 (2015).

term that includes a grant) to comply with Office of Management and Budget (OMB) Circular A-122, titled "Cost Principles for Non-Profit Organizations."[2] *Id.* § 74.27(a) (Oct. 1, 2014).

The cost principles in OMB Circular A-122 govern whether, or to what extent, a non-profit organization's expenditure of federal funds is "allowable" – that is, may be charged to a federal award. 2 C.F.R. § 230.20(a) (Jan. 1, 2013). The Circular provides that a grantee's costs must meet various general criteria in order to be allowable. *Id.*, Part 230, App. A, ¶ A.2. For example, a grantee's costs must be "reasonable for the performance of the award," "allocable to" the award, and "adequately documented." *Id.*, App. A, ¶¶ A.2.a, A.2.g, and A.4. OMB Circular A-122 also sets forth principles applicable to specific types of costs. *Id.*, App. B. Of relevance here, the Circular states that interest on borrowed capital is unallowable except for interest on debt incurred to acquire or replace capital assets. *Id.*, App. B, ¶ 23.

In addition to mandating compliance with federal cost principles, the Part 74 regulations require grantees to comply with standards of financial management. 45 C.F.R. § 74.20-.21 (Oct. 1, 2014). For example, grantees must have financial management systems that provide "[e]ffective control over and accountability for all funds" and ensure that funds "are used solely for authorized purposes." *Id.* § 74.21(b)(3) (Oct. 1, 2014).

If a Head Start grantee "materially fails to comply with the terms and conditions" of its award – including the requirements specified in, or incorporated by, 45 C.F.R. Part 74[3] – ACF may impose one or more enforcement remedies, including "[d]isallow[ing] (that is, deny[ing] both use of funds and any applicable matching credit for) all or part of the activity or action not in compliance." 45 C.F.R. § 74.62(a)(2).

Under the "applicable regulations and cost principles, a grantee bears the burden of documenting the existence and allowability of its expenditures of federal funds." *Touch of Love Ministries, Inc.*, DAB No. 2393, at 3 (2011).

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[2] Until 2014, OMB Circular A-122 was codified – in its entirety and format – in Appendix A of 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).

[3] *Bright Beginnings for Kittitas County*, DAB No. 2623, at 2 (2015) (citing 45 C.F.R. § 1301.10(a) and stating that compliance with Part 74 requirements is a term and condition of a Head Start grant).

Case Background

In accordance with the Single Audit Act,[4] an independent accounting firm performed a financial and compliance audit of the Council's 2013 fiscal year (March 1, 2012 through February 28, 2013). Exhibit (Ex.) A-3.[5] The auditor's findings are set out in a November 2013 report. *Id.* Among other things, the auditor found that the Council had "incurred a significant loss" during the 2013 fiscal year "due to . . . debt which was incurred to finance operations." *Id.* at 8. The reported loss was $1,560,983 – equal to the amount by which the Council's current liabilities ($1,746,304) exceeded its current assets ($239,321) for the fiscal year. *Id.* at 6-7, 18. The auditor also found "deficiencies" in the Council's accounting and financial management practices. *Id.* at 24, 27, 30-39. In the auditor's judgment, those deficiencies posed a risk of fraud or misuse of funds and compromised the Council's ability to provide accurate reports of its financial position. *Id.* The auditor recommended measures to correct the deficiencies. *Id.* at 30-39.

The HHS Office of Inspector General (OIG) reviewed the audit report. In April 2014, the OIG notified the Council that it concurred with the independent auditor's findings and recommendations. Ex. A-4.

In response to the audit, the Council advised the independent auditor and ACF that it had taken measures, or planned to take measures, to correct the reported deficiencies and prevent further financial losses. Ex. A-3, at 40-43; Ex. A-1, at 2. In September 2014, ACF performed an onsite visit of the Council to review the status and sufficiency of the Council's corrective measures. Ex. A-1, at 1; Ex. A-8. ACF also "did a cursory review of liabilities during the current and prior grant year to try to determine what was causing current liabilities to exceed current assets by such a large amount." Ex. A-1, at 2. According to ACF, this review "showed [that] unallowable cost liabilities were routinely incurred by the [Council] and . . . were then paid with Federal Head Start grant funds[.]" *Id.* ACF identified what it thought were five categories of unallowable expenditures by the Council:

> the use of $479,484.59 in "current year" Head Start grant funds to pay "prior year expenses";
>
> $838,597.15 in payments on an "unapproved" line of credit;

[4] Under the Single Audit Act, a non-profit grantee whose expenditure of federal funds in any fiscal year exceeds a certain threshold must undergo a single, comprehensive financial and compliance audit for that year that meets the standards in OMB Circular A-133 (titled "Audits of States, Local Governments, and Non-Profit Organizations"). 31 U.S.C. § 7502(a)(1)(A); 45 C.F.R. § 74.26(a) (Oct. 1, 2014).

[5] The Council submitted Exhibits A-1 and A-2. ACF submitted Exhibits A-3 through A-12.

$4,377.50 in payments to a "grant writer" to prepare a grant application;

$46,422.49 for "late fees" incurred in paying the organization's bills;

$404.38 for life insurance for the Council's executive director.

Id. In addition to identifying these allegedly unallowable expenditures, ACF determined that the Council had not yet corrected certain deficient financial management and accounting practices. *Id.* at 3-9.

ACF notified the Council of its findings in a December 29, 2014 letter. Ex. A-1. Under finding 009930100, ACF stated it was disallowing the expenditures mentioned in the previous paragraph, expenditures totaling $1,369,286.11. *Id.* at 2. There were seven other findings in the letter, five of which alleged uncorrected accounting and financial management deficiencies. There were no disallowances associated with those other findings.

The Council then filed this appeal. Each party has submitted a brief. In support of its appeal, the Council submitted no evidence other than a copy of ACF's December 29, 2014 letter and excerpts from two HHS Grants Policy Directives.[6]

Discussion

As indicated, ACF disallowed five groups of expenditures. The Council's appeal brief mentions only two: the use of $479,484.59 in Head Start funds awarded for one funding period to cover obligations from prior funding periods; and payments totaling $838,597.15 on an unapproved line of credit. We address these expenditures in sections A and B below.

The Council takes no issue with ACF's disallowance of: (1) $4,377.50 to pay a grant writer; (2) $46,422.49 for late fees incurred in paying the organization's bills; and (3) $404.38 for life insurance for the Council's executive director. We therefore summarily affirm ACF's disallowance of those expenditures.

[6] Grants Policy Directives (GPDs) contain department-wide policies governing the award and administration of grants issued by the U.S. Department of Health and Human Services (HHS), including grants issued under the Head Start program. GPD 1.03A, available at http://www.hhs.gov/asfr/ogapa/aboutog/ogpoe/gpdhome.html.

Finally, the Council asks us to review ACF's findings that it continues to have accounting and financial management deficiencies. We decline to do so for reasons stated in section C.

A. The Council failed to rebut ACF's determination that it violated 45 C.F.R. § 74.28 when it used $479,484.59 in Head Start grant funds awarded for one funding period to cover obligations incurred in earlier funding periods.

Although a Head Start grantee obtains multi-year approval for its program, ACF funds the program with discrete annual awards, with each award corresponding to a 12-month "funding period"[7] (sometimes called a "budget period") and an ACF-approved "budget plan." *See* 45 C.F.R. § 74.25(a); *Action for a Better Cmty., Inc.*, DAB No. 2014, at 2 (2007).

Section 74.28 of the uniform administration requirements states that when an award specifies a funding period, "a [grantee] may charge to the award only allowable costs resulting from obligations[[8]] incurred during the funding period . . . ." 45 C.F.R. § 74.28. That prohibition flows from the requirement in OMB Circular A-122 that a grantee's costs be "allocable to" the federal award:

> Charges to federal grant awards by non-profit organizations . . . must be allocable to the federal award, i.e., of benefit to the activities for which the grant was awarded. The term "benefit," as used in connection with the concept of allocability, derives from accounting principles that the costs must relate not only to cost objectives, but to funding periods as well. The fact that expenditures are incurred outside their grant periods necessarily means that they are not allocable to the grants and is a sufficient basis in itself for a disallowance. Grantees seeking to charge pre-award costs to federal awards must accordingly obtain the permission of the awarding agency, which is authorized to grant waivers permitting recipients to charge pre-award costs to federal awards.

River East Economic Revitalization Corp., DAB No. 2087, at 6 (2007) (citations and internal quotation marks omitted).

[7] The term "funding period" is defined in the Part 74 regulations to mean "the period of time when Federal funding is available for obligation by the recipient." 45 C.F.R. § 74.2.

[8] The term "obligations" is defined in Part 74 as "the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the [grantee] during the same or a future period." 45 C.F.R. § 74.2.

Here, ACF determined that the Council used $479,484.59 in Head Start funds awarded for the "current" funding period (presumably, the Council's 2013 fiscal year) to cover obligations incurred in earlier funding periods. See Ex. A-1, at 2; Response Br. at 8. The Council admits that it used the funds in that fashion, stating that it incurred allowable costs in fiscal years 2008 through 2012 but "paid" the costs "with Federal Grant Funds in following grant years." App. Br. at 11. Section 74.28 provides one exception to its prohibition on charging an award for pre-funding-period costs: a grantee may charge an award for "*pre-award costs* authorized by the HHS awarding agency pursuant to 45 C.F.R. § 74.25(d)(1)." 45 C.F.R. § 74.28 (italics added). "Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance." 2 C.F.R. Part 230, App. B, ¶ 36. The Council does not allege that any of the disallowed expenditures relate to pre-award costs authorized by ACF under section 74.25(c)(1) and the record provides no evidence that would even suggest this exception might be relevant here. Accordingly, we need not consider it further.

In short, the Council concedes that its grant-funded expenditures totaling $479,484.59 materially failed to comply with section 74.28 and the allocability cost principle, both of which are terms and conditions of its Head Start awards. ACF was therefore authorized to disallow the expenditures. 45 C.F.R. § 74.62(a)(2) (authorizing disallowance of an action that materially fails to comply with award terms and conditions); *Central Piedmont Action Council, Inc.*, DAB No. 1916 (2004) ("Grant expenditures incurred outside of the applicable budget periods are not allocable to awards for those budget periods, and this violation of the requirement of allocability is a basis for a disallowance.").

Although the Council concedes that "corrective action by ACF is proper," it submits that disallowance is an improper remedy. App. Br. at 11. According to the Council, "a disallowance and required repayment . . . would result in ACF being paid twice for allowable costs." *Id.* In addition, says the Council, the disallowance "would result in unjust enrichment by the government of a 501(c)(3) non-profit corporation in violation of the Internal Revenue Code." *Id.* The Council further states that "ACF must give the Appellant credit for the allowable costs $479,000 paid and seek recover[y] in a legal constitutionally acceptable manner." *Id.*

We reject these assertions for two reasons. First, the Council has not even explained what it means by its enigmatic assertion that the federal government would somehow be paid twice, much less offer any evidence or legal analysis to support the assertion. Nor does the Council justify its suggestion that ACF has acted in an unlawful or unconstitutional manner.

Second, the Board has no authority to impose a different remedy for the Council's noncompliance. The Board is "bound by all applicable laws and regulations." 45 C.F.R. § 16.14. Accordingly, we must affirm a disallowance "where [it] is authorized by law and the grantee has not disproved [its] factual basis[.]" *Central Ala. Comprehensive Health, Inc.*, DAB No. 2625, at 3 (2015). As indicated, the disallowance of $479,484.59 is authorized by law (section 74.62(a)), and the Council has not disproved its factual basis (use of current-year grant funds to cover prior-year obligations). We must therefore sustain the disallowance. If the Council is suggesting that ACF should (or could) impose a different enforcement remedy, consideration of such a suggestion is not within our authority. "[I]n discussing the enforcement options available [to the federal agency] under [45 C.F.R. §] 74.62, the Board has stated that the 'selection and timing of an enforcement action from among the lawful options is a matter committed to the discretion of the awarding agency.'" *Professional Counseling Resources, Inc.*, DAB No. 2448, at 9 (2012) (*quoting National AIDS Educ. & Servs. for Minorities, Inc.*, DAB No. 2401, at 17 (2011)).

Finally, the Council cites or quotes from a Board decision and a Grants Policy Directive that discuss "retroactive approval." App. Br. at 11-13. As provided in longstanding HHS policy and explained in numerous Board decisions, an awarding agency under certain circumstances has discretion to approve retroactively an expenditure or other grant-related transaction. *See* Grants Policy Directive 3.05 (providing that the awarding office may "grant approval retroactively" of "costs . . . that require prior approval" and that a request for retroactive approval will be examined "on its merits" to determine the costs' permissibility under governing statutes, regulations, and cost principles); *City of Charleston, S.C.*, DAB No. 866 (1987) (stating that "[r]etroactive approval provides funding despite a grantee's failure to comply with a prior approval requirement where the expenditure was otherwise allowable and clearly furthered the purpose of the grant"); *Brown Magnolia Cmty. Dev. Corp.*, DAB No. 1917 (2004) (discussing retroactive approval provisions of the HHS Grants Administration Manual).

The Council does not explain whether or how any of the disallowed expenditures would qualify for potential retroactive approval under the applicable law or policy directives. Indeed, the Council has not even alleged that it asked ACF to grant retroactive approval. Accordingly, we decline to direct ACF to consider whether retroactive approval should be granted. *Southwest Va. Cmty. Health Systems, Inc.*, DAB No. 2605, at 14 n.12 (2014) ("Where a grantee has not requested retroactive approval, [the Board has] no basis for directing the federal agency to consider whether retroactive approval should be granted.").

B. The Council failed to demonstrate that its payments on a line of credit were allowable expenditures under the terms and conditions of its Head Start grants.

Based on bank records and other information, ACF determined that between 2008 and 2014, the Council used $838,597.15 in Head Start funds to make unallowable payments on an "unapproved" line of credit. *See* Ex. A-1, at 2; Response Br. at 8, 11; Ex. A-9, ¶ 6. According to CMS, the initial balance on the credit line was $200,000. Response Br. at 11. CMS found that the balance had "increased to $1 million" by 2014 "because [the Council [had] paid interest rather than the principal amount of the loans." *Id.*; *see also* Ex. A-1, at 2.

The Council does not deny that it made the loan payments identified by ACF or that its line of credit was "unapproved" (that is, not part of the Council's approved Head Start budget plans). App. Br. at 13-14. To the extent the payments covered interest on the borrowed funds, they are unallowable under OMB Circular A-122 unless they relate to debt incurred by the Council to acquire or replace capital assets for its Head Start program. 2 C.F.R. Part 230, App. B., ¶ 23. The Council does not allege that the payments fell under that exception or were otherwise allowable under the terms and conditions of its Head Start awards. The Council merely asserts that "$839,597.00 were paid out of the loans obtained by Appellant." App. Br. at 13. This statement's meaning is unclear. If the Council is implying that the payments were made entirely with non-federal funds (that is, loan proceeds), it offered no evidence to support that factual claim or explain how that circumstance necessarily entitled it to a reduction of the disallowance. For these reasons, we find that the Council impermissibly used Head Start grant funds to make loan payments totaling $838,597.15 and conclude that ACF lawfully disallowed them under 45 C.F.R. § 74.62(a)(2).

C. The Board lacks the authority to review ACF's findings that the Council has not yet corrected financial management deficiencies identified by the independent auditor.

The Council asks the Board to overturn – as substantively incorrect or a violation of due process – ACF's findings that it has not corrected certain financial management deficiencies identified by the independent auditor. App. Br. at 6-8. ACF responds that the Board lacks the authority to review these findings. Response Br. at 7.

The Board's jurisdiction is limited. In general, that jurisdiction extends only to the programs and types of "final written decisions" specified in Appendix A to 45 C.F.R. Part 16. *See* 45 C.F.R. § 16.3 (providing for Board review in disputes arising under programs which use the Board for dispute resolution, as explained in Part 16's

Appendix). Relevant here is the jurisdiction to review the types of final written decisions specified for "direct, discretionary project programs." *See* 45 C.F.R. Part 16, App. A, ¶ C; *N.Y. Human Resources Admin.*, DAB No. 641, at 3 n. * (1985) (indicating that Head Start is a direct, discretionary project program).

ACF's findings concerning the Council's accounting and financial management practices are not the types of final written decisions specified in Appendix A for direct, discretionary grant programs.[9] More specifically, none of the findings constitute a disallowance, denial of payment, termination, or voiding of the grant. Moreover, none of the findings was cited by ACF as a basis for the previously discussed disallowance. The Board therefore lacks the authority to review them, and we decline to do so for that reason. *See Galveston County Cmty. Action Council*, DAB No. 2514, at 12 (2013) (declining to review ACF's decision to audit a Head Start grantee because the decision was not among the types of appealable decisions specified in the paragraph of 45 C.F.R. Part 16, Appendix A that pertains to direct, discretionary project programs).

Conclusion

For the reasons stated, we sustain ACF's December 29, 2014 determination to disallow the Council's expenditure of $1,369,286.11 in Head Start grant funds.

/s/
Constance B. Tobias

/s/
Leslie A. Sussan

/s/
Sheila Ann Hegy
Presiding Board Member

[9] The Board also reviews appeals authorized by relevant program regulations or memoranda of understanding between the Board and the head of the appropriate HHS operating component. 45 C.F.R. Part 16, App. A, ¶ A. The Head Start program regulations pertaining to grantee appeals do not identify an appealable decision at issue in this case. *See* 45 C.F.R. § 1303.12-.15. In addition, the Board is unaware of any relevant memoranda of understanding.