

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: Southern Methodist University
Docket No. 76-8
Decision No. 41

DATE: October 19, 1977

DECISION

This is an appeal by Grantee, Southern Methodist University, from the decision of the Regional Commissioner of Education, Region VI, dated January 15, 1976, disallowing several items of cost based upon audit findings. Grantee held several successive Upward Bound grants identified as Grant No. OEG-O-71-2648 (1972-1973), hereinafter referred to as 2648, grant No. OEG-6-73-1060 (1973-1974), hereinafter referred to as 1060, and Grant No. OEG-6-73-1060 Extended (1974-1975), hereinafter referred to as 1060 Extended. The items of disallowance fall into two categories: (a) room and board charges, and (b) audit costs, and will be separately considered.

The Regional Commissioner disallowed \$8,425 of the former costs charged to Grant 1060 on the ground that such costs were not incurred during the 1973-1974 budget year to which they were charged. The Regional Commissioner also disallowed \$2,488 expended by Grantee for audits, by the firm of Ernst & Ernst, of Grantee's 1972-1973 and 1973-1974 budget periods, as in excess of the total amount budgeted for the purpose.

Room and Board Charges

Of the \$8,425 room and board costs which were disallowed, \$6,687 was incurred in the 1972-73 budget period under Grant 2648 (1972-1973), and \$1,738 was incurred in the 1974-75 budget period under Grant 1060 Extended. The costs were initially charged to the respective accounts for those years and later transferred to the 1973-74 grant account, 1060. This transfer enabled Grantee to avoid overdrawing its grant funds under 2648 for 1972-73 budget year. (Letter from Grantee dated 5/27/77 to Departmental Grant Appeals Board, item 2).

Grantee contends that the audit report concluded that the costs in question were found to be allowable, the only question raised was their proper assignability to the 1060 grant. In support of the propriety of charging the 1060 grant for costs incurred under 2648 it argues that it "acted with due prudence in the circumstances, considering their responsibility to the institution, its employees, its students, the Government, and the public at large," quoting from FMC 73-8, par. C.3(c). It also con-

tends that the reallocation of costs was in accordance with verbal instructions received at Regional and National Upward Bound Management seminars. (Appeal, p.4, item 3).

The Regional Commissioner, in his response of July 23, 1976 to Grantee's appeal, denies that any such advice was given by anyone in the USOE Regional Office. In response to this Board's request of May 6, 1977 that Grantee furnish the dates, times and places of the seminars and the OE officials who on such occasions provided oral instructions or authority to transfer costs in the manner effected by Southern Methodist, the Grantee was unable to provide such information. (Grantee's letter 5/27/77, item 1.) In lieu thereof, it stated that it had been an acceptable practice under the OEO administration of the program to allow grantees to assign costs incurred during a period when two grants or budget periods overlapped to either grant or budget year. This practice, Grantee claims, was reinforced by information exchanged between SMU's Upward Bound program director and his counterparts at other institutions.

In that same response, Grantee conceded that funds in 2648 were insufficient to cover the \$6,687.00 of disallowed costs charged to the 1060 grant. It was also stated that \$1,738 of costs incurred under 1060 Extended were charged to 1060 since the funds under the latter grant had not been fully expended and that was in conformity with Grantee's practice of fully expending former year funds subject to a determination that there was a balance available.

Whatever may have been the Grantee's practices under OEO administration of the program, the propriety of the allocation of costs at issue here must be considered by reference to the grant terms and conditions made applicable to these grants by the Office of Education. The appeal file contains the OE Notification of Grant Award on 2648 covering the grant period 5/1/71 through 6/30/72. It directs that the grant "shall be administered in accordance with: (1) Special Provisions (attached hereto), and (2) 1970-71 Upward Bound Guidelines and Supplement #1 thereto."

Appendix B of those Guidelines provides the Grant Terms and Conditions for Upward Bound Projects. Sec. 3, "Limitations on Costs," provides:

"a. The total cost to the Government for the performance of the Grant will not exceed the amount set forth in the Notification of Grant Award or any appropriate modification thereof. The Government shall not be obligated to reimburse the Grantee for costs incurred in excess of such amount unless and until the Grants Officer shall have notified the Grantee in writing that such amount has been increased and shall have specified in a revised Grant Award a revised amount which shall thereupon constitute the revised total cost of performance of the Grant."

Paragraph (e) of that same section further provides that "all costs are subject to the limitations as specified in the Upward Bound Guidelines appropriate to the grant period."

Reference to the audit report indicates that the \$6,687 amount in dispute represents room and board charges incurred under the 2648 grant and charged to the 1060 grant. Although these costs may have been incurred during a period of overlap of the two grants, (Grantee's letter of 5/27/77, item 1.) they clearly constitute costs incurred in performance of the former grant and are, therefore properly allocable to it. As stated in Exhibit X-2-68-1 of the DHEW Grants Administration Manual (incorporated by reference in the Guidelines by Sec. 4a.(3) of Appendix B of the Guidelines a cost is allocable to a Government contract/grant if it is "incurred specifically for the contract/grant." Since this item of cost was incurred specifically for the benefit of and under 2648 it must properly be allocated to it, unless otherwise specifically authorized. Moreover, the nature of this item being room and board costs for students under the 2648 grant, it is beyond argument that any benefit from incurrence of such cost could inure to 1060.

In this connection, we would point out that 1060 represents a new and discrete grant, rather than an extension or renewal of 2648. It was made in consequence of an entirely new and unrelated application, the Notification of Grant Award identifying it as new grant (see Box 7), assigning to it both a different grant number (See box 2) and a new Project Number (see Box 3).

In its appeal, Grantee concedes that the 2648 grant funds were inadequate to cover the room and board expenditures in question but does not even attempt to justify charging them to 1060 other than to claim their incurrence during the overlap period. That temporal accident does not, in the Board's view, provide a basis for allocating any part of that cost to a new grant which derived no benefit whatever from such expenditure.

With respect to Grantee's claim that this was a permissible practice under OEO and was verbally approved by OE officials, we have already noted that these grants were made by OE and not OEO, and subject to terms and conditions prescribed by OE. As indicated above Grantee has not been able to support its claim of oral instruction or authorization in a manner adequate to overcome the above-quoted limitation of the Government's obligation to the amount of the grant award.

Finally, no consideration of the allocability of a cost would be complete without reference to Sec. C.4.b. of Appendix A of FMC 73-8 (formerly OMB Circular A-21) which is incorporated by reference in the Guidelines for this program (1972-1973 Guidelines, page 50) and made applicable to Educational Services agreements by Appendix B. Grantee acknowledges that this provision is applicable and has quoted it in its appeal. It provides:

"Any costs allocable to a particular research agreement... may not be shifted to other research agreements in order to meet deficiencies caused by overruns or other fund considerations, to avoid restrictions imposed by law or by terms of the research agreement, or for other reasons of convenience."

Because the costs in question were in excess of the grant funds available, charging them to the 1060 would be in direct contravention of the above quoted prohibition as a device calculated to meet a deficiency caused by an overrun.

For the foregoing reasons, the Board denies Grantee's appeal from the disallowance of \$6,687 incurred under 2648 and charged to the 1060 grant.

Turning now to the disallowance of the \$1,738 incurred under 1060 Extended but charged to 1060, the situation is somewhat different. For one thing, Grantee asserts -- and it has not been controverted -- that sufficient funds were available in 1060 Extended to cover these costs. Thus, allocating them to 1060 cannot be deemed to have been done to avoid deficiencies. We next consider whether such action violates the other aspects of the above quoted provisions in FMC 73-8.

Although as the record on appeal does not so disclose, we are aware that Grant 1060 was made after application therefor was submitted pursuant to "Supplemental Instructions to Accompany the Trio Program Manual for the 1973-1974 Program Manual and Application Forms." Those instructions initiated, for the 1973-1974 funding cycle, a multi-year project approval system. It stated:

" For the purpose of this system, all applications for 1973-1974 funds will be regarded as new applications; therefore, it will be necessary for applicants to project goals and activities over a three-year period. A detailed budgetary breakdown for each budget period is to be made a part of the application, and projects which are approved for multi-year support will be funded in annual installments called budget periods. Under this system of multi-year support, carry-over funds at the end of any budget period are available for use during the entire life of the project."

Elsewhere, the Instructions provide that the "grantee is allowed to incur costs from the Effective Date of the Grant. Thus, reasonable costs incurred after the grant is awarded but prior to the formal beginning of the program may be included as items for which reimbursement is requested.... The grantee, however, will not be allowed to recover any costs prior to the effective date of the grant."

Unfortunately the term "grant" is not itself defined in the Instructions. However, in order to give meaning and effect to both of the quoted portions of the Instructions, it would appear to be necessary to attribute to the term "grant" as used in the latter context the status of a new grant. This would accommodate the concept of a project period, which is defined as:

"11. Project Period: The total time for which a project or portion thereof is approved for support including any competitive extensions. The length of the project should be determined

by the operating agency on the basis of two primary considerations: the length of time required to complete the project, and the frequency of competing review desirable for proper management of the grant program. The length of the project period approved therefore may be less than the period requested by the applicant."

and the policy of availability of carry-over funds for use during the entire life of the project.

The Notification of Grant Award dated 5/24/74 covering 1060 Extended, refers to itself, in Block 9, "Scope of Work", as "this grant revision covers the 2nd budget period of this Upward Bound Project." It further provides that the grant will be administered in accordance with: "45 C.F.R., Part 100, DHEW, Office of Education, General Provisions for Programs,...Federal Register... November 6, 1973, Volume 38, Number 213," and General and Special Grant Terms and Conditions, both attached. Section 4 of the General Grant Terms and Conditions governing allowable costs provides:

"Expenditures of the grantee may be charged to this grant only if they: (1) Are in payment of an obligation incurred during the grant period and (2) conform to the approved project proposal."

A conflict appears to exist between the Instructions pursuant to which Grantee submitted its applications for both 1060 and 1060 Extended and the General Terms and Conditions, published, as regulations of OE, in the Federal Register. Although this Board recognizes that the regulations have the full force and effect of law which the administrative instructions are not competent to supersede, we are constrained to take account of the confusion which such seemingly inconsistent issuances inevitably generate. At the very least, it is arguable that the Instructions constituted a blanket authorization in writing for carrying forward into a succeeding budget year unexpended funds of a previous budget year in a multi-year project grant.

The very form of application (OE Form 1251, 2/73, approved by OMB No. 51 R0896) calls for budget estimates for the 2nd and 3rd years of the activity, in addition to the 1st year's fund request. The application form supports the multi-year project concept set forth in the Supplemental Instructions.

In response to the Board's request a copy of Grantee's application dated 3/27/73 was furnished by the Regional Commissioner. (Memo from Regional Commissioner to the Board dated 7/27/77.) The form calls for requests for first, second and third years of the project and Grantee supplied its budget requests or estimates. In the narrative portion of its application it identified (page 1) the proposed dates of activities as: "June 1,

1976." It also contained 2nd and 3rd year narrative statements regarding activities and goals for those years. Clearly, then, Grantee's application was in conformance with the multi-year project system set forth in OE's Supplemental Instructions.

In view thereof it is the opinion of this Board that since the 1060 Extended costs were allocated to the 1060 1973-1974 budget year in accordance with the Instructions issued by the OE, notwithstanding the limitations contained in the regulations, we sustain Grantee's appeal on this item. It should be clearly understood, however, that this Board is not according to the Instructions any status of supremacy over the regulations. This would be beyond the authority conferred upon this Board. By this part of our decision, we merely hold that in the circumstances of this case, we think that the Grantee acted reasonably and prudently in conforming to the Instructions, although those same Instructions were not consistent with the published regulations. That inconsistency was the creature of the Office of Education for which this Grantee should not be held responsible.

Audit Costs

The matter of audit costs presents a simpler issue. Grantee's budget for 2648 and 1060 each carried an allocation of \$356 for audits for the respective 1972-1973 and 1973-1974 project periods. Grantee engaged the firm of Ernst & Ernst to perform the audits and was billed a total of \$3,200 for both audits, for which a combined report was issued. The Regional Commissioner disallowed \$2,488 of the audit expenditures, the amount by which the combined costs exceeded the two budget items. The basis for the disallowance is set forth in the Regional Commissioner's Memorandum of July 23, 1976, in the appeal record as follows:

"Justification for the disallowance is contained in the Grant Terms and Conditions under article 4 (allowable costs) and article 2 (scope of the project). Article 4 states that 'Expenditures of the Grantee may be charged to this grant only if they.... (2) conform to the approved project proposal. Article 2 states that 'no substantive changes in the program of a project shall be made unless the Grantee submits an appropriate amendment thereto, along with the justification for the change, and this amendment is approved in writing by the Grants Officer.'

"This office maintains that the amount expended by the Grantee for the audit does not conform to the approved project proposal and that the Grantee made substantive changes in the program without prior Grants Officer approval."

On the other hand, Grantee contends that the budget "seriously underestimated" the amount necessary. It argues further that because the costs

were necessary and did not alter the performance of the approved program or result in cost overruns, the expenditure falls within Article 3.b. of the Grant Terms and Conditions which permits "transfer of funds among the various cost categories in the negotiated budget to the extent necessary to assure the effectiveness of the project." We agree with Grantee's assertion and reject the Regional Commissioner's contention that the expenditure of that amount either constituted a substantive change in the program of the project or that it failed to conform to the project proposal.

Essentially, then, the issue boils down to the question of whether the amount was reasonable. In support thereof, Grantee has submitted copies of invoices rendered to it by Ernst & Ernst for audits conducted in connection with Department of Commerce, Office of Minority Business Enterprise grants. The Regional Commissioner stated that he considered the amounts charged Grantee for auditing these grants to be excessive.

In response to the Board's request for justification for the costs of the audits, or independent support, Grantee requested Ernst & Ernst to provide same. Ernst & Ernst attempted to do so by its letter of June 10, 1977, in which it identified three Department of Commerce audits it had conducted for which it had billed comparable amounts. It further stated that the audit procedures were in accordance with generally accepted auditing standards and in compliance with the respective audit procedures of the two departments, noting that "many of the audit objectives and procedures performed in connection with the audits involved were similar in nature." However, no indication is given as to whether the requirements of the two departmental audit requirements were comparable. Since the amounts charged for the audits were questioned, it would have been helpful if Ernst & Ernst had supported its billing by indicating the amount of time devoted to each of the audits, their hourly billing rates, etc. Notwithstanding the absence of such specific information, we think the charge for the audits is reasonable. HEW experience in the costs of audits of its grant programs is fully supportive of the reasonableness of the amounts billed. Based on hourly rates generally charged by certified public accountants and other professionals, the initial budget allocations of \$356.00 per audit appears to the Board to be unrealistic and totally inadequate. Accordingly, Grantee's appeal on this item is sustained.

/s/ Bernice L. Bernstein

/s/ Francis D. DeGeorge

/s/ Manuel B. Hiller, Panel Chairman