

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Sweetwater Health Services, Inc.  
Docket No. 79-98  
Decision No. 125

DATE:  
October 3, 1980

DECISION

This case is before the Departmental Grant Appeals Board (Board) on appeal from a decision of the Public Health Service (PHS) Grant Appeals Board issued on April 20, 1979 regarding Sweetwater Health Services, Inc. (SHS, grantee). The PHS Board upheld three of four audit disallowances by the Office of Health Maintenance Organizations (OHMO), PHS. The disallowances involve determinations by the PHS Board that: (1) SHS could not account for \$406.68 transferred to SHS from a prior grantee; (2) SHS did not demonstrate that \$2,587.46 expended for legal services was payment for services to SHS; and (3) SHS lacked sufficient documentation for \$17,560.15 in cash and in-kind contributions SHS claimed as its non-Federal share.

This decision is based on grantee's appeal, PHS's response to the appeal and an Order to Develop the Record, and the parties' comments on the Draft Decision issued by the Board. The Draft Decision invited comments from the grantee and PHS but noted that unless the parties provided persuasive new information or arguments, the Board might issue a decision in substantially the same form.

Background

Wyoming Health Services, Inc. (WHS), was awarded a Federal grant in April 1972 (08-P-000019-01-0) to study the feasibility of establishing a Health Maintenance Organization (HMO) in Sweetwater County. In January 1973, WHS received a grant of \$150,817 (08-P-000019-02-0) for the purpose of developing an HMO in Sweetwater County. During this time, local physicians and community leaders had formed SHS, and worked with WHS to develop an HMO for their locale. SHS was incorporated in June 1972 for the stated purposes of developing an organized health delivery system and an HMO.

In May 1974, WHS formally requested that OHMO transfer Grant No. 08-P-000019-02-0 to SHS, noting that SHS had had operational authority over the project since June 1973. In June 1974, SHS formally requested that it be designated as the grantee and stated that it was willing to accept responsibility for the grant. SHS also said it was in possession of the remaining grant funds. WHS's report of expenditures through May 31, 1974 showed a total outlay of \$129,749. The grant was transferred and the Notice of Grant Award to SHS showed a total approved budget of \$21,068 (\$150,817 - \$129,749). The award noted that "[a]ll terms and conditions imposed on the original grant remain in effect."

SHS was awarded a grant in its own right in the amount of \$205,781 for the period from October 1, 1974 through September 30, 1975 (08-P-000036-01-0). The term of the grant was subsequently extended through November 30, 1975 to allow SHS to close out the HMO project.

When the HEW (now HHS) Audit Agency reviewed SHS's expenditures, it found that SHS had not maintained an adequate financial management system. The Audit Agency found it necessary to retain the services of a certified public accountant firm to construct the records necessary to determine whether all the Federal funds were accounted for. Audit Agency Report, Audit Control No. 08-81600, p.3. The CPA firm determined that in addition to the lack of accounting records, SHS had been lax in several administrative areas, including a general lack of detail in the documentation of most expenditures. The firm did not believe, however, that there was a misappropriation of Federal funds or gross negligence in handling the affairs of the organization.

I. Fund Shortage

PHS found that on June 1, 1974, when the grant was transferred to SHS, the Federal fund balance was \$21,068.00. The audit showed, however, that only \$20,661.32 could be accounted for, resulting in a fund shortage of \$406.68. SHS argued that the discrepancy could be reconciled. In the June 8, 1979 request for PHS review of the OHMO determinations, SHS explained that in January 1974, it paid the Travel Management Agency \$727.06 by check no. 1131 for air travel expenses (voucher no. 1341), but WHS did not record this expense. In addition, SHS reportedly received a \$250.00 reimbursement for management services prior to the grant transfer, but this receipt was not recorded by WHS. According to SHS, the reconciliation would work out as follows:

Grant transfer	\$21,068.00
Minus travel expenses	727.06
Plus reimbursement, and	250.00
Petty Cash	70.20
Adjusted balance	<u>20,661.14</u>
Balance per audit report	<u>20,661.32</u>
Fund shortage	.18

SHS hypothesized that there was an error in accounting for petty cash during the audit.

PHS, apparently in response to SHS's argument regarding the fund shortage, reviewed the audit work papers and determined that travel voucher no. 1341 was prepared June 30, 1974 to record \$727.06 as an expenditure for June 1974 and that check no. 1131 was listed as outstanding on the bank reconciliation. Inasmuch as the check was never paid, the CPA firm cancelled it and the travel voucher thereby reducing travel expenses by \$727.06.

The Board does not find SHS's explanation of the fund shortage persuasive. Even if it was established by proper documentation that the check to the travel agency

was paid, this would not explain the discrepancy in petty cash and the lack of documentation for the alleged receipt of the \$250 reimbursement. In fact, SHS's explanation raises more questions than it answers. The check in question was allegedly paid to the travel agency in January 1974 but the travel voucher was not prepared until June 1974. Likewise, the check had still not cleared the bank six months after it was allegedly issued. The CPA firm's bank reconciliation was for June 30, 1974, a date subsequent to the transfer. Thus, if the check had not been cashed by that date, it would not have had any effect on the amount of cash on hand, funds transferred or petty cash as of May 31, 1974, and SHS is accountable for the fund shortage as of that date.

It is unnecessary, however, to speculate as to the effect of such adjustments on the fund balance. When SHS accepted Federal funds, it accepted the responsibility to properly account for the use of the funds. Section 1307 of Public Law 93-222 (42 USC 300e-6), which authorizes the making of this type of grant, stipulates that, "[e]ach recipient of a grant...shall keep such records as the Secretary shall prescribe, including records which fully disclose the amount and disposition by such recipient of the proceeds of the grant...and such other records as will facilitate an effective audit." Federal regulations which implement the law set forth with specificity the record keeping requirements and the accountability of a grantee. See 42 CFR 110.211-213, and 45 CFR 74.20(a), 38 FR at 26277, September 19, 1973. The Board finds that SHS did not maintain proper records and was not able to account for the \$406.68 fund shortage. Thus, SHS will be held responsible for this amount of public funds entrusted to its use and care.

## II. Legal Expenses

PHS disallowed \$2,587.46 that SHS paid to a law firm for legal services because the bill included charges attributable to Medical Services, Inc. (MSI), as well as to SHS, and there was insufficient documentation to allocate the respective shares. MSI was an organization active in developing health care delivery in Sweetwater County. An October 25, 1974 bill from the law firm to SHS, for the period from January 1 through September 30, 1974, showed as the subject matter "SHS-MSI." The professional services in question were listed as: conferences; Green River Clinic memo; MSI-hospital lease; PA contracts; and SHS contracts. The total amount of the bill was \$3,294.32, but documentation indicated that MSI reimbursed SHS for \$706.86 of the costs. PHS had requested a breakdown of the costs but SHS stated that the law firm was reluctant to furnish the data because of its lack of detailed information.

An analysis of the law firm's bill shows that only one of the listed items, "SHS Contracts," is identifiable as services rendered to SHS. One of the other items - "MSI-Hospital Lease" - is directly identifiable as services rendered to MSI, and two others are indirectly attributable to MSI operations. According to the evidence of record, MSI entered into a contract with the Green River Chamber of Commerce to staff the Green River Clinic and employed at least some Physician Assistants (PAs). Thus, the "Green River Clinic Memo" and the "PA Contracts" appear to represent services rendered to MSI. When a cost benefits both the grant and other endeavors, the regulation at 45 CFR Part 74, Appendix F, Section B.4, requires that the costs be divided in proportion to the benefits received.

Although it is impossible to determine from the bill itself how much time was devoted to each activity, there is no evidence that SHS received over three-quarters of the legal services which would justify paying over three-quarters of the cost. In fact, the face of the bill indicates that MSI received most of the services. SHS was given several opportunities, but did not produce sufficient evidence of its expenditures. Accordingly, the Board sustains the disallowance of the legal expenses.

### III. Non-Federal Matching Expenditures

PHS disallowed \$17,560.15 SHS claimed as cash and in kind contributions for lack of sufficient documentation. The Notice of Grant Award, as amended in December 1974, states that SHS was required to provide 10 percent of the grant expenditures (\$17,819). The cost sharing could have consisted of cash or in-kind contributions furnished by either grantee or a third party. See PHS Supplement, Grants Administration Manual 1-400-20c.

The Audit Agency Report indicated that SHS claimed as non-federal share \$16,029 in cash received from MSI and the Priorities Board of Sweetwater County (Priorities) and \$1,805 in in-kind contributions by Priorities for physician recruitment. The money from Priorities was for shared administrative salaries and support costs related to clinic planning and development; the funds from MSI were to pay MSI's share of the salary for SHS's Director of Clinic Management and for shared administrative costs. See Audit Report, p. 7.

#### A. Physician Recruitment

In support of its position with respect to physician recruitment costs, SHS contends that one of the purposes of the grant was to recruit physicians to practice in Sweetwater County. Therefore, SHS argues that the costs of activities of other parties in furthering this end could be considered non-Federal matching funds.

SHS's application for an initial HMO development grant lists "recruiting" as a project activity. The detailed budget submitted with the application allocated \$25,000 to physician recruiting with \$15,400 to be paid by the applicant and others, and \$9,600 by grant funds. The budget notes that "[p]hysician recruiting expenses will allow the project to address its major problem; a significant level of community matching funds will be provided to attempt to attract more doctors." One of the project goals was "[t]o recruit personnel for the organization, with emphasis on physician recruiting."

Although a September 1974 memorandum from a Regional HMO Program Consultant recommended that PHS reduce the SHS budget by \$9,600 because "recruiting physicians to the community but not to the HMO per se ... was not a developmental cost properly chargeable to the HMO grant," PHS did not reduce the budget.

PHS apparently allowed recruitment costs which were borne by SHS itself, but disallowed such costs as matching funds when they were expended by Priorities. It is fundamental grant administration policy that, as pertinent here, matching funds and Federal funds are subject to the same rules of allowability governing project costs. See 45 CFR 74.52. Thus, if recruitment costs were allowable expenditures from grant funds, they should be allowable as third party in-kind contributions. The Board does not find PHS's rationale for this disallowance to be reasonable. It is difficult to conceive how the relative benefits derived from recruiting physicians to the HMO service area could be allocated between the HMO and the general population of the HMO service area. There was an identity of interests in this objective, and both parties derived the full benefit of the recruitment. Accordingly, the Board finds that the \$1,805.30 which Priorities expended for recruitment is allowable as matching funds.

#### B. Administrative Costs and Clinic Development

The Board finds that Priorities' and MSI's payments to SHS can not be regarded as non-Federal share. The payments appear to have been reimbursement for services rendered to MSI. The CPA firm's report stated that SHS and MSI shared office space, secretaries and other business expenses for a period of time. MSI reimbursed SHS for those expenses and at the time of the audit owed SHS \$2,376. The report also stated that the auditors never found any support for salary or fee reimbursement between SHS and MSI. The auditors believed that the activities of SHS and MSI should have been separated.

The Audit Agency also stated that although there was some indication that the expenditures were intended to benefit the HMO, it could not locate any source documents which showed that the cash or in-kind contributions directly benefited the HMO developmental activities; thus, it was not possible to determine the extent to which the contributions constituted the non-Federal share.

SHS argued that it had received funds and services in support of two of five major project activities set forth and approved in the grant application, namely, physician recruiting and ambulatory care facility development. These contributions came from Priorities and MSI. SHS also alleged that it maintained time logs to document staff efforts and allocated them to authorized activities. It was grantee's belief that the auditor reviewed these records, although SHS was unable to locate them when responding to PHS on January 8, 1979. SHS argued that it was essential to develop an adequate health delivery system if the HMO were to succeed and that this was understood and supported by the Federal officials administering the grants. In view of this, SHS thought that the positive results of SHS physician recruitment and clinic development activities ought to provide sufficient evidence that the contributions were of direct benefit to the grant. SHS also stated that the officials reviewing the audit apparently did not understand that the HMO being developed was an individual practice association prototype which required a community based health development program.

The payments from MSI to SHS were characterized as reimbursement. Likewise, although MSI reportedly paid half of the salary of SHS's Director of Clinic Management, it appears that such payment represented reimbursement for services. The Audit Agency's report observed that the grant approved a position entitled

entitled Director of Clinic Management but the tasks described in the grant application are directed at the acquisition of ambulatory care facilities for SHS rather than the management of such facilities for others.

MSI was not a non-profit corporation. It was engaged in activities which could, and usually do, provide a return on investment. Under these circumstances, the payments to SHS must be regarded as a business transaction in which MSI paid for services rendered by SHS employees, not as a contribution to further the purposes of the grant.

Priorities' payment to SHS for shared administrative salaries and support costs related to clinic planning and development no doubt facilitated the recruitment of physicians by providing adequate office and treatment space, but SHS did not own and operate the clinics in question as an adjunct or part of the proposed HMO. Likewise, there is no evidence that Priorities' activities were intended to produce treatment facilities and a medical support substructure for the HMO. Priorities' goal was to increase treatment capabilities in Sweetwater County. Community leaders and area employers were willing, in effect, to subsidize medical practitioners to achieve this end. While this may have constituted an example of enlightened civic-mindedness, it was not the purpose of the grant and similar expenditures by grantee would not be allowed. An activity must be explicitly included within the scope of the grant before it may be considered for purposes of computing the non-Federal share. The fact that the activity may, as a secondary result, have a beneficial effect on the purpose of the grant is insufficient. Accordingly, the Board concludes that Priorities' payments to SHS were compensation for services received and not a contribution to further the purpose of the grant.

#### Conclusion

As discussed above, the decision of the PHS Grant Appeals Board is affirmed except for \$1805 expended for physician recruiting.

/s/ Clarence M. Coster

/s/ Norval D. (John) Settle

/s/ Donald G. Przybylinski, Panel Chair