Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Child Development Council of Acadiana, Inc.
Docket No. A-13-75
Decision No. 2574
May 27, 2014

DECISION

Child Development Council of Acadiana, Inc. (CDCAI), a Head Start grantee, appealed the April 2013 determination of the Administration for Children and Families (ACF) disallowing $1,855,599 in federal funding for the February 1, 2010 - January 31, 2011 period. ACF determined that CDCAI improperly claimed: 1) $1,155,646 to construct a new building without obtaining ACF's prior approval; 2) $852,904 of unallowable non-federal share cash and in-kind contributions (including $745,010 in local funds used for the building construction), requiring a disallowance of $682,323 in federal funds; and 3) $17,630 for items that were not recognized as ordinary and necessary for the performance of the award. ACF based the disallowance on a 2012 audit report by the Office of Inspector General (OIG).

For the reasons discussed below, we sustain ACF's determination that the building construction costs were unallowable because CDCAI failed to obtain the required prior written approval for the expenditures. We also explain that the record does not support CDCAI's contention that ACF officials led it to believe that ACF authorized the expenditures. We further describe why we reject CDCAI's request to remand this matter to ACF for further consideration.

CDCAI indicated in its notice of appeal that it intended to contest all of ACF's April 2013 determination findings. CDCAI's briefs, however, addressed only the disallowance of $1,155,646 in construction costs and $596,008 of the non-federal share disallowance, representing 80% of the $745,010 in local matching funds used for the building construction. Because CDCAI ultimately did not dispute ACF's disallowance of CDCAI's non-federal share contributions that were unrelated to the building construction or the disallowance for items that were not recognized as ordinary and necessary, we sustain those disallowances without further analysis of them.

I. Legal Background

Head Start is a national program that provides comprehensive health, education, nutrition, social, and other services primarily to low-income children, three to five years old, and their families. 42 U.S.C. § 9831 *et seq.*

Nonprofit organizations such as CDCAI that receive Head Start awards must comply with the administrative requirements at 45 C.F.R. Part 74, with certain exceptions not relevant here. 45 C.F.R. § 1301.10. Section 74.21(b)(1) requires a grantee to maintain financial management systems that provide for accurate, current, and complete disclosure of the financial results of each program sponsored by the Department of Health and Human Services (HHS). Under section 74.21(b)(3), a grantee's financial management systems must provide for effective control over and accountability for all funds and assure that they are used solely for authorized purposes. The grantee also must maintain records that identify the source and application of funds for HHS-sponsored activities and cost accounting records supported by source documentation. 45 C.F.R. §§ 74.21(b)(2), 74.21(b)(7). In addition, the Head Start regulation at 45 C.F.R. § 1304.51(h) requires that grantees establish and maintain efficient and effective reporting systems that generate official reports for federal authorities as required by applicable law. These reports include semi-annual, annual and final financial status reports. 2 C.F.R. §§ 215.50-215.52; ACF-PI-HS-11-01.

A nonprofit grantee also must comply with the Office of Management and Budget (OMB) cost principles in OMB Circular A-122, codified at 2 C.F.R. Part 230 (OMB A-122). 45 C.F.R. §74.27(a). To be allowable charges to a grant, costs must be reasonable for the performance of the award and allocable to it. OMB A-122, Attachment (Att.) A, ¶ A.2.a. A cost is reasonable if it is of a type generally recognized as ordinary and necessary for the operation of the organization or performance of the award, and allocable in accordance with the relative benefits received. *Id.* ¶¶ A.3.a., A.4. Grantees must adequately document costs charged to an award. *Id.* ¶ A.2.g. Capital expenditures, including expenditures for improvements to land or buildings, which materially increase their value, are unallowable as direct charges, except where approved in advance by the awarding agency. *Id.* at Att. B, ¶ 15.

As discussed in greater detail below, section 644(g) of the Head Start Act (Act), 42 U.S.C. § 9839(g), requires the Secretary of HHS to approve the use of Head Start funds for capital expenditures to construct a Head Start facility before the grantee may make

such expenditures.[1] The Secretary has established implementing procedures at 45 C.F.R. Part 1309 that a grantee must follow to use Head Start funds to purchase, construct, or make major renovations to Head Start facilities and actions required to protect the federal government's interest in such facilities. 68 Fed. Reg. 23,212 (2003).[2]

With certain exceptions not relevant here, the Act and regulations require each grantee to provide at least 20 percent of the total cost of its Head Start program through non-federal share, consisting of in-kind donations or cash received from third parties or contributed by the grantee. Act, § 640(b); 45 C.F.R. § 1301.20. Under section 74.23(a) of the regulations, all cost-sharing or matching contributions must meet the same criteria for allowability as costs incurred and paid with federal funds, that is, they must be "necessary and reasonable for proper and efficient accomplishment of project or program objectives" and "allowable under the applicable cost principles."

If a nonprofit Head Start grantee "materially fails to comply with the terms and conditions of an award, whether stated in a Federal statute or regulation, an assurance, an application, or a notice of award," ACF may, among other remedies, "[d]isallow (that is, deny both use of funds and any applicable matching credit for) all or part of the cost of the activity or action not in compliance." 45 C.F.R. § 74.62(a)(3).

II. Case Background

A. The OIG Audit

In March 2011, the OIG began an audit of CDCAI's financial management practices and systems. CDCAI Ex. J at BN 106.[3] The OIG issued its final audit report in September 2012, concluding that CDCAI failed to meet multiple federal requirements. CDCAI Ex. Q (OIG Audit Report A-06-11-00031).

[1] The current version of the Head Start Act can be found at http://eclkc.ohs.acf.hhs.gov/hslc/standards/Head%20Start%20Act/. Each section of the Act on that website contains a reference to the corresponding United States Code chapter and section.

[2] Under section 1309.3, "Construction means new buildings, and excludes renovations, alterations, additions, or work of any kind to existing buildings."

[3] The pages of CDCAI's appeal file (consisting of CDCAI exhibits A through U) are numbered consecutively with the prefix "BN" before each page number. We cite each referenced or supporting document by exhibit letter and "BN" number(s).

The OIG found that CDCAI spent at least $1,155,646 in federal Head Start funds to construct a new building, used for program administration and parent training, without obtaining the necessary prior approval by ACF. *Id.* at BN 206, 213-214. The OIG noted that CDCAI had submitted at least two applications for Head Start funds to construct a new building, but ACF had denied CDCAI's requests. *Id.* at BN 214.

The OIG also found that CDCAI had not accurately accounted for the construction costs. "Rather than include the construction costs in a construction account," the OIG stated, "CDCAI included them in other accounts, including . . . 'maintenance and repair,' 'ARRA [American Recovery and Reinvestment Act] Early Head Start expenditures for classroom supplies,' and 'ARRA Early Head Start expenditures for minor repairs.'" *Id.* Moreover, the OIG found, CDCAI failed to record a Notice of Federal Interest in the property in the local jurisdiction records, as required by section 1309.21 of the Head Start regulations; "improperly used" the building "as collateral on two loans[;] and failed to disclose in its 2009 and 2010 financial statements that the building was pledged as security for the first loan." *Id.* at BN 206, 214.

The OIG further concluded that CDCAI claimed $852,904 for unallowable donations and in-kind goods and services. That amount consisted of $745,010 in local funds used for the building construction and $107,894 in unallowable in-kind contributions, including parents' supervision of their own children, prior period costs, and parents' costs of transporting children to school. *Id.* at BN 215.

In addition, the OIG found that CDCAI claimed $17,630 in operating expenditures for items not recognized as ordinary and necessary for the performance of its award. *Id.* at BN 216. For example, the OIG stated, "CDCAI reimbursed parents for the cost of parent socials and for Christmas gifts that benefited individual children." *Id.*

Based on these and other findings, the OIG recommended that the Secretary take numerous remedial actions against CDCAI, including disallowing the costs that the OIG found unallowable.

B. CDCAI's Request for Retroactive Approval of Construction Costs

On April 12, 2011, after the OIG audit was underway, CDCAI submitted to ACF an application for retroactive approval of its use of Head Start funds to construct its new administrative office and parent-training facility. CDCAI Ex. N; CDCAI Reply at 3. By e-mail dated April 20, 2011, ACF notified CDCAI that it had received the application and that additional information was required by regulation to complete the application. CDCAI Ex. I. On April 26, 2011, CDCAI sent ACF additional information. *Id.* By letter dated April 28, 2011, ACF's Office of Head Start, Acting Regional Program Manager, denied CDCAI's retroactive approval request. CDCAI Ex. O.

C. ACF's Determination

In April 2013, ACF issued a determination to disallow in total $1,855,599 of CDCAI's claimed costs for the February 1, 2010 - January 31, 2011 period based on its review of the OIG audit and additional documentation provided by CDCAI. CDCAI Ex. T. ACF concluded that CDCAI used $1,155,646 of federal Head Start funds to construct its new building without obtaining the necessary prior approval. Consistent with the OIG findings, ACF also determined that CDCAI had not properly accounted for and reported these expenditures. Because ACF did not rescind its initial disapproval or grant retroactive approval for CDCAI to use federal funds to construct the facility, ACF disallowed $1,155,646 in federal funds used for the construction expenditures.

ACF further concluded that CDCAI failed to file timely the required Notice of Federal Interest in the property, improperly used the new building as collateral on two loans, and failed to disclose in its 2009 and 2010 financial statements that the building was pledged as security for the first loan. ACF noted that CDCAI had later taken corrective actions to address these issues, including filing the required Notice of Federal Interest in the property with the St. Landry Parish Clerk of Court.

In addition, ACF determined that the OIG correctly questioned $852,904 of CDCAI's claimed non-federal matching funds, consisting of $745,010 in local donations used for the building construction and $107,894 in unallowable in-kind contributions. Finally, ACF determined that the OIG "was correct in questioning" $17,630 in claimed operating costs "for items that generally were not recognized as ordinary and necessary for the performance of the award." *Id.* at BN 308-309.

III. Analysis

A. ACF properly disallowed funds used by CDCAI to construct its new Head Start facility without obtaining the required prior written approval.

The federal statutes and regulations governing the allowable use of Head Start funds require a grantee to obtain a responsible ACF official's written approval to use Head Start funds for capital expenditures to construct a Head Start facility before construction begins. Section 74.25(b) of the regulations obligates nonprofit grantees to "request prior approvals for budget and program plan revisions, in accordance with this section." Part 74 defines "prior approval" as "written approval by an authorized HHS official evidencing prior consent." 45 C.F.R. § 74.2. Under section 74.25(c)(5), nonprofit grantees must seek prior approval to revise their budgets to include costs that would require prior approval under OMB A-122, unless prior approval has been waived. Section 74.25(k)(1) states that approval of a budget or program plan revision must be signed by the "Head of the HHS Operating or Staff Division that made the award or

subordinate official with proper delegated authority from the Head, including the Head of the Regional Office of the HHS Operating or Staff Division that made the award." OMB A-122 provides that capital expenditures for buildings are unallowable as direct charges, except where approved in advance by the awarding agency. Att. B at ¶ 15.b.(1).

Additional statutory and regulatory requirements apply specifically to the use of federal Head Start funding for capital expenditures to construct a Head Start facility. Section 644(g) of the Act provides in relevant part:

> (1) Upon a determination by the Secretary that suitable facilities (including public school facilities) are not otherwise available to Indian tribes, rural communities, and other low-income communities to carry out Head Start programs, that the lack of suitable facilities will inhibit the operation of such programs, and that construction of such facilities is more cost effective than purchase of available facilities or renovation, the Secretary, in the discretion of the Secretary, may authorize the use of financial assistance under this subchapter to make payments for capital expenditures related to facilities that will be used to carry out such programs. The Secretary shall establish uniform procedures for Head Start agencies to request approval for such payments, and shall promote, to the extent practicable, the collocation of Head Start programs with other programs serving low-income children and families.
>
> (2) Such payments may be used for capital expenditures (including paying the cost of amortizing the principal and paying interest on, loans) such as expenditures for-
>
> (A) construction of facilities that **are not in existence on the date of the determination;**
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> *** * ***
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> (3) All laborers and mechanics employed by contractors or subcontractors in the construction or renovation of facilities to be used to carry out Head Start programs shall be paid wages at not less than those prevailing on similar construction in the locality, as determined by the Secretary of labor in accordance with the Act of March 3, 1931, as amended (40 U.S.C. 276a *et seq*., commonly known as the "Davis-Bacon Act").

(Emphasis added.) As the Board explained in *Marie Detty Youth and Family Services Center, Inc.*, DAB No. 2024, at 38 (2006), the emphasized language indicates that the determination "to authorize the use of financial assistance" to build a facility must take place prior to the construction of the facility. "In addition," the Board noted, "since the grantee must 'request approval for such payments' and since ACF can approve such a

request only after making the specific determination[] required by the statute, the statute anticipates that a grantee will not spend grant funds for this purpose before receiving ACF's approval." *Id.*

The regulations implementing the statute describe the steps that a grantee must take to establish "eligibility" to use Head Start funds to construct a facility. "Before submitting an application" to use federal funds to construct a Head Start facility, a grantee "must establish" that it "serves an Indian Tribe; or is located in a rural or other low-income community." 45 C.F.R. § 1309.4. The grantee also must establish that there "is a lack of suitable facilities," in its area, "as demonstrated by a statement that neither [its] current facility nor any facility available for lease in the service area is suitable for use by the Head Start program." *Id.* The statement must explain the factors considered in making the determination and "be supported whenever possible by a written statement from a licensed real estate professional in the grantee's service area." *Id.*

Sections 1309.10 and 1309.11 of the regulations describe the information that must be included in an application for approval to use Head Start funds to construct a new Head Start facility. The elements consist of, among other things, a legal description of the site of the facility and an explanation of the appropriateness of the location to the grantee's service area; a written estimate of all costs associated with the project prepared by an architect or engineer; a comparison of the costs of constructing the facility to the costs of purchasing a suitable alternative facility or owning, purchasing, or leasing an alternative facility which can be made suitable through renovations; and assurances that the project complies with local and federal licensing, construction, access, and environmental safety laws. Sections 1309.51 through 1309.54 establish additional procedures that a grantee must follow before advertising and awarding a construction contract and during the construction process.

Section 1309.12, "Timely decisions," provides that the "responsible HHS official shall promptly review" and make a final decision on a grantee's application for authorization to use Head Start funds to construct a facility. Section 1309.3 of the regulations defines the term "responsible HHS official" to mean "the official who is authorized to make the grant of financial assistance to operate a Head Start program, or such official's designee." Thus, the prior written approval that a grantee must obtain before using federal Head Start funds as capital expenditures for the construction of a Head Start facility must come from an individual officially authorized to award Head Start funding, or such official's designee.

Applying the statutory and regulatory requirements here, we conclude that ACF properly disallowed CDCAI's construction costs because CDCAI failed to obtain from a responsible HHS official the necessary prior written approval for the expenditures. CDCAI, "like other grantees, had an obligation to be aware of the federal laws governing

the allowable uses of Head Start funds and to conform its expenditures to those laws." *Marie Detty* at 38. CDCAI nevertheless used Head Start funds that had been budgeted for other purposes for unauthorized capital expenditures. As discussed more fully below, CDCAI also failed to disclose and accurately account for these expenditures.

B. *The record does not support CDCAI's claim that ACF officials led it to believe that the building construction expenditures were authorized.*

CDCAI asserts "that ACF officials previously led CDCAI to believe that its use of Head Start funds for facility construction was authorized." CDCAI Br. at 8. CDCAI argues that the building it previously rented and used for administrative and parent training functions was unsafe and that CDCAI constructed the new facility to ensure staff and parent safety. According to CDCAI, it submitted "no fewer than five applications to ACF for one-time supplemental funding." CDCAI Reply at 2.[4] CDCAI contends that ACF delayed acting on and ultimately denied those requests for supplemental funding without explanation. *Id.* "When it became clear that ACF would not make additional funds available," CDCAI contends, it "obtained advice from ACF instructing CDCAI to use the resources that it had available to carry out the relocation, then acted in a manner consistent with that advice." *Id.* at 3.

To support this argument, CDCAI relies on Board of Directors meeting minutes from September 2009 (three months before groundbreaking). At that meeting the Head Start Program Director told the Board that she had discussed funding with the Regional Office Head Start Program Specialist, who "advised" the Program Director "to proceed on to get a facility and to get the staff out of" the building it had been using for administrative functions. CDCAI Ex. F at BN 63. According to CDCAI, a March 2011 e-mail from the Program Specialist, containing his "standard reply to correspondence received from Head Start grantees [whose] unsolicited one-time applications have not been funded," "confirmed these instructions." CDCAI Br. at 3, n. 1 *citing* CDCAI Ex. G at BN 66. The e-mail stated the grantee should "[u]se whatever funds are available to do whatever needs to be done. Just make certain that Head Start Program expenditures are allowable: 1. Allocable, 2. Reasonable, and 3. Necessary." CDCAI Ex. G at BN 66.

CDCAI's contentions are not persuasive. CDCAI could not reasonably think that oral or after-the-fact approval would be sufficient to allow it to use "available" funds to construct the facility. The requirement for prior written approval applies not only when a

[4] In response to the OIG audit preliminary findings, CDCAI represented that it "submitted seven (7) One Time Applications requesting funds to build an office facility." CDCAI Ex. Q at BN 225; *see also* CDCAI Ex. G at BN 66. CDCAI's exhibits in this case include copies of two such requests. CDCAI Ex. C ("Supplemental Application, 'Emergency Request,' Construction of New Central Office, July 30, 2007" and "Emergency Request Supplemental Application, Construction of New Central Office, October 1, 2008").

grantee seeks supplemental funds but also when a grantee seeks to re-budget "available funds" previously awarded for other purposes in order to cover capital expenditures. The language of the Act requires ACF's prior written approval for a grantee to use federal funds to construct a Head Start facility regardless of whether the grantee proposes to use supplemental award funds, annual award funds, or funds provided under any other type of Head Start award, agreement, or contract. The wording of section 644(g) of the Act, quoted above, provides the Secretary with discretion to authorize the use of "financial assistance under this subchapter" to pay for capital expenditures to construct a Head Start facility. Section 637 of the Act defines the term, "financial assistance," to include "assistance provided by grant, agreement, or contract . . . ." Implementing the Act, sections 1309.1 and 1309.10 of the regulations provide that a grantee that proposes to use "grant funds" to construct a Head Start facility must submit a written application to the responsible HHS official for approval. Section 1309 defines "grant funds" to mean "Federal financial assistance received by a grantee from ACF to administer a Head Start program pursuant to the Head Start Act." Thus, the authorization described in section 644(g) of the Act and the implementing regulations must be obtained where a grantee seeks to use for construction costs federal funds provided under any type of Head Start grant.

In sum, as the Board previously explained, the issue is not how much a grantee "spent or whether it requested additional funds but that it spent funds appropriated for non-capital expenditures on capital expenditures without seeking prior approval to do so . . . ." *Marie Detty* at 41. Similarly, the Part 74 provisions, read together with OMB A-122, require prior written approval for a grantee to re-budget previously awarded funds to cover capital expenditures.

Furthermore, even as described in the Board of Directors meeting minutes, the purported guidance that the Program Specialist gave to CDCAI's Program Director to "get a facility" could not reasonably be understood as authorization for CDCAI to use previously awarded Head Start funds as capital expenditures for the construction of its new building. CDCAI Ex. F at BN 63. The Board Meeting Minutes do not show that CDCAI clearly communicated to ACF that CDCAI intended to use previously awarded funds for capital expenditures to construct a new building. Rather, the minutes merely state that CDCAI's Program Director reported that she had "let [the] new rep[resentative] at [the] Regional Office know that an office is being built and funds may be used along with local dollars to acquire this facility." *Id.* Thus, assuming the minutes accurately reflect the conversations between CDCAI's Program Director and the Regional Office (and CDCAI did not offer any affidavits or testimony to support its claims), the Program Specialist's instruction for CDCAI to "get a facility" may simply have meant that CDCAI should find an alternative location to lease.

In any event, the subsequent e-mail confirming the Program Specialist's alleged oral advice to CDCAI clearly states that CDCAI had to "make certain" that any expenditure was "allowable." CDCAI Ex. G at BN 66. As explained above, under the applicable statute, regulations, and cost principles, federal funds for capital expenditures to construct a new building are not allowable if the grantee has failed to obtain an authorized HHS official's written approval for the expenditures prior to construction. CDCAI points to no evidence that it was led to believe that a responsible HHS official had provided such prior written approval. Moreover, even if the evidence showed that the Program Specialist explicitly told CDCAI's Program Director that CDCAI could use any available funds to construct the new building (which it does not), such oral advice plainly would not satisfy the prior approval requirement because it was not written and CDCAI has not presented argument or evidence that the Program Specialist was a "responsible HHS official," authorized to award financial assistance.[5]

C. We reject CDCAI's request for remand.

The Board has observed that in "grant programs generally, retroactive approval may be granted for transactions that would have been approved had the grantee requested approval in advance." *Arizona Affiliated Tribes, Inc*., DAB No. 1500 (1994). The Board has held that where retroactive approval is permitted, the awarding agency "may consider all relevant factors," including "a grantee's fiscal management history," in deciding whether to approve the request. *Id*. While the Board "will not interfere when the federal agency appropriately exercises its discretion, the agency must state the basis for its decision and may not deny retroactive approval based on unsubstantiated conclusions or on bases so insubstantial that the decision fairly can be described as capricious." *Id. citing Economic Opportunity Atlanta, Inc.*, DAB No. 313 (1982).

Here, CDCAI asks the Board to vacate ACF's disallowance of the construction costs and associated non-federal share expenditures and remand the matter to ACF for it to consider CDCAI's retroactive approval request "on the merits." CDCAI Br. at 7. CDCAI contends that ACF's decision to deny its request for retroactive approval "relied exclusively on the fact that the request was retroactive in nature," which "is not a sufficient basis for rejecting CDCAI's request." *Id.* CDCAI argues that an HHS Grants Policy Directive required ACF to examine the request "on its merits" and not deny it "solely because of timing." *Id. citing* HHS Grants Policy Directive 3.05(d)(3)[6]

[5] We note that the terms and conditions of HHS awards usually identify the persons authorized to grant approval for budget and program plan revisions where such approval is required.

[6] The current version of the HHS Grants Policy Directives is available at: http://www.hhs.gov/asfr/ogapa/aboutog/ogpoe/gpd3-05.pdf.

We conclude that remanding this matter to ACF for further consideration is not appropriate or warranted. The policy issuance cited by CDCAI, HHS Grants Policy Directive 3.05.D., describes HHS grants management staff and program officials' responsibilities in reviewing and responding to requests for retroactive approval to make changes to an approved project or budget. The directive instructs staff and officials to examine a request for retroactive approval "on its merits, including **whether the requested action is permissible under the governing statute, regulations, and policies (allowability)** and, if applicable, whether it meets the cost principle tests of reasonableness and allocability." (Emphasis added.) Thus, the directive recognizes that retroactive approval of a grantee's use of award funds for expenditures that were not authorized under the award may not be permitted under the specific statutes and regulations that govern the type of award and expenditures at issue.

In this case, ACF asserted that the denial of CDCAI's request for retroactive approval was "based on the specific requirements of the federal statute and regulations that require the grantee to obtain prior written approval from the appropriate authorizing official before spending grant funds for construction." ACF Br. at 11, *citing* CDCAI Ex. O; Act § 644(g); 45 C.F.R. Part 1309. Thus, according to ACF, the Head Start Act and implementing regulations preclude ACF from granting a request for retroactive approval where, as in this case, a grantee has used Head Start funds for unauthorized capital expenditures for construction without establishing eligibility and securing ACF's approval prior to construction. This reading of the law is reasonable in light of the explicit requirements for prior approval in section 644(g) of the Act and sections 1309.4, 1309.10, and 1309.11 of the Head Start regulations. Those provisions evidence an intent to approve use of Head Start funds for construction only where there is adequate advance assurance of the need and assurance that Davis-Bacon Act and contracting requirements will be met.

Furthermore, assuming ACF ever has the discretion under Part 1309 to grant a request for retroactive approval to use grant funds for construction, we would not consider withholding such approval to be capricious or unwarranted under the circumstances presented here. As noted, the Board has held that retroactive approval may be granted for transactions that "would have been approved had the grantee requested approval in advance." DAB No. 1500, at 7. This is certainly not such a situation, given that CDCAI itself acknowledges that it submitted numerous applications for funding to build the new facility prior to construction and that ACF denied those requests. For instance, the record includes a January 21, 2009 letter from the ACF Regional Program Manager to CDCAI stating that ACF had received CDCAI's November 2008 application for funding for the central administration building and advising CDCAI that ACF would not fund the construction. CDCAI Ex. E.

In any event, even if CDCAI had not requested and been denied prior approval for the construction expenditures, we would see no need to remand this matter for ACF's further consideration because CDCAI's application for retroactive approval failed to include all of the information, documentation, and assurances that a grantee must submit to ACF in order to establish eligibility, to complete an application for approval, and to advertise and award contracts for the construction. For example, section 1309.4(b) provides that to establish eligibility for construction, a grantee must show that neither its current facility nor any facility available for lease in its service area is suitable for use by the Head Start program, and the grantee's assertion must be supported, when possible, by a written statement from a licensed real estate professional.[7] Section 1309.10(b) requires the grantee to include in its application "a written estimate of all costs associated with the project" that is prepared by a licensed architect or engineer. Sections 1309.10(c) and 1309.11 require the grantee to include in its application a detailed comparison of the costs of constructing the facility to the costs of purchasing a suitable alternative facility or owning, purchasing, or leasing an alternative facility which can be made suitable through renovations. Section 1309.51 provides that a grantee may not award a contract for any part of construction until it has submitted to the responsible HHS official final working drawings and written specifications for the project, and a written estimate of the costs of the project by a licensed architect or engineer.

CDCAI's April 12, 2011 application for retroactive approval failed to include the above-described and other required information and documentation. CDCAI Ex. N. On April 20, 2011, ACF notified CDCAI of the omissions and gave CDCAI an opportunity to supplement its application. CDCAI Ex. I at BN 88-89. Even after CDCAI supplemented its submission on April 26, 2011, however, the information and documentation remained insufficient. For example, to satisfy the requirement at section 1309.4(b) that the grantee establish that there are no facilities available for lease in its service area, CDCAI provided statements that it "has been searching for another facility to lease or rent since 1995 and there are no available facilities suitable for use" and "the buildings that were looked at were not ready to be used – were in need of major renovations and repairs. . . ." CDCAI Ex. I at 91. According to CDCAI, the "groundbreaking [for the new building] took place in December 2009, the certificate of completion issued in December 2010, and the punch list was finished in late January 2011." CDCAI Br. at 3. The statement by a licensed real estate appraiser that CDCAI submitted to support its action, however, was dated April 25, 2011 and was based on the

[7] Section 1309.3 defines "suitable facility" as "a facility which is large enough to meet the foreseeable needs of the Head Start program and which complies with local licensing and code requirements and the access requirements of the Americans with Disabilities Act (ADA), if applicable, and section 504 of the Rehabilitation Act of 1973."

appraiser's evaluation of properties available **for sale as of April 21, 2011**. CDCAI Ex. I at BN 97, 99-103. CDCAI submitted no documentation to show an evaluation of the facilities in its service area that were available for lease or sale prior to constructing the new building.

Furthermore, to satisfy the requirements that it provide the project plans, drawings and specifications, and all associated costs of the project prepared by an architect or engineer, CDCAI submitted a one-page document that listed "Rooms and Spaces" (e.g., "Lobbies," "Director's Office," "Conference Room," etc.) and the corresponding square-footage of each room or space. *Id.* at BN 93. The only other information on the page was the "Total Building" square footage, the "Total Contract" amount, total "Architectural Fees," the "Total Project Cost," and the "Balance due on Facility." *Id.* Not only did CDCAI fail to provide the construction plans, drawings, specifications, and a breakdown of the costs for the facility that it had already built, CDCAI also failed to indicate on the one-page document it did submit that the information on it was prepared by an architect or engineer.

With respect to the cost comparison required under section 1309.11, ACF specifically asked CDCAI to submit information on "what would have been the cost to make the facility that was leased suitable for the same purpose of the constructed facility." CDCAI Ex. I at BN 89. In response, CDCAI provided statements that if it "continued to lease [the] facility, the entire building would have to be totally gutted;" there "would not have been a savings – the cost for maintaining this facility would have been continuous and on-going;" and the "leased facility was beyond renovation/repair and the cost would have exceeded the price for [the] newly constructed building." *Id.* at BN 90, 94. Although CDCAI did state that replacement "air conditioner-heating units . . . would have cost $2,000 and at least ten would have been needed," CDCAI provided no other data showing what the other necessary renovations and repairs to its leased facility would have cost. *Id.* at BN 90. Rather, CDCAI stated that the entire facility needed to be rid of pests and mold, that there "was no guarantee that the building could have been rid[] of [pests]," and that the mold in the building "could not be washed away or removed." *Id.* The cost-comparison table that CDCAI provided did not compare the costs of renovating the facility it previously leased with the costs of constructing the new facility. Rather, the table compared the cost of paying for its new building over a period of 15 years, based on borrowing $976,000 with the cost of paying for the building in five years, based on the remaining loan balance due of $95,366. *Id.*

Moreover, ACF's disallowance letter gave additional reasons for ACF's denial of retroactive approval that were not articulated in ACF's April 28, 2011 letter. The disallowance letter noted CDCAI's failures to account properly for its expenditures and to meet the regulatory requirements ensuring the protection of the federal government's interest in the property, as reported by the OIG. Specifically, CDCAI's financial records included the construction costs in other accounts that concealed the nature of the capital

expenditures, including "maintenance and repair," "ARRA . . . Early Head Start expenditures for classroom supplies," and "ARRA Early Head Start expenditures for minor repairs." CDCAI Ex. Q at BN 214; CDCAI Ex. T at BN 304. Moreover, the OIG concluded, "CDCAI may also have included construction expenditures in other accounts," and "there is no assurance that all construction-related expenditures have been identified." CDCAI Ex. Q at BN 214. CDCAI did not directly dispute these findings but reported in response to the OIG's draft report that it subsequently took corrective action to accurately account for the expenditures "through adjusting entries . . . in the general journals." CDCAI Ex. Q at BN 231.

CDCAI also did not dispute that it failed to file a Notice of Federal Interest in the building in the property records when it began the construction, as required under 45 C.F.R. § 1309.21(d)(2). CDCAI subsequently "filled out" the Federal Interest Form on April 12, 2011, but did so only in response to the OIG's preliminary findings. CDCAI Ex. Q at BN 231.[8] "Because CDCAI did not file a Notice of Federal Interest for property that the Federal Government holds an interest in," the OIG found, "the property could be transferred or sold to another party without the written permission of the responsible HHS official." *Id.* at BN 214. Similarly, CDCAI did not contest on appeal that it used the new building as collateral on two loans, and failed to disclose in its 2009 and 2010 financial statements that the building was pledged as security for the first loan.[9]

To justify the expenditures, CDCAI focuses on the deficiencies of the property that it rented prior to March 2011. CDCAI asserts that it "determined as of 2003 that the site was not suitable for continued use due to persistent and unresolved problems with the physical plant." CDCAI Br. at 1. According to CDCAI, subsequent hurricanes exacerbated the building's problems, and it became necessary to move out of the building to ensure the health and safety of employees and parents.

While it may have been necessary for CDCAI to find alternative space for its administrative functions, the Head Start Act makes clear that the use of limited federal

[8] CDCAI contends that if "the Board upholds the disallowance, CDCAI must be permitted to remove the Notice of Federal Interest recorded on the property and to use the property as security for debt." CDCAI Br. at 8; CDCAI Reply at 6. Section 1309.21, "Recording of Federal interest and other protection of Federal interest," appears to make the grantee's obligation to record a Notice of Federal Interest in a property contingent upon the actual use of federal funds to purchase, construct, or renovate the property. *See also* 45 C.F.R. § 74.32(c)(1). Thus, if CDCAI pays back all of the federal funds it used in the construction, ACF may permit CDCAI to remove the Notice of Federal Interest, but our decision to uphold the disallowance would not automatically have that effect.

[9] CDCAI suggests that ACF's denial of retroactive approval was arbitrary and capricious because the Regional Office Grants Management Officer was predisposed against CDCAI. P. Br. at 4, 8, *citing* CDCAI Ex. L at BN 111 (April 7, 2011 e-mail from ACF Grants Management Officer). Even if ACF had questions about CDCAI's leadership (as the cited e-mail indicates), that would not change our conclusion that ACF had ample legal grounds for denying CDCAI's request for retroactive approval.

resources for capital expenditures to construct a new Head Start building is contingent upon a grantee demonstrating that construction is more cost-effective than other available options. Here, CDCAI states that based on its 2003 assessment of the problems with its rental space, it "purchased [in 2004] a two acre lot with an eye toward constructing a new facility . . . ." *Id.* at 2; CDCAI Ex. D. CDCAI, however, provided no evidence that in the 2003-2004 period – or at any time prior to constructing its new building – it obtained cost estimates of available renovation, lease, or purchase options and that the costs of these options exceeded the cost of building its new facility. To the contrary, CDCAI's 2007 and 2008 applications for approval to construct the facility stated: "Any other facility that this agency would attempt to lease would have to be brought up to current building code requirements and those cost[s] would be **near** the amount of construction of a new facility." CDCAI Ex. C at BN 18, 43 (emphasis added). Failing to obtain approval for those applications, CDCAI nevertheless proceeded to use funds awarded for operating expenses for capital expenditures that were plainly unauthorized. ACF reasonably declined to approve those expenditures retroactively.

IV. Conclusion

For the foregoing reasons, we uphold the disallowance in full.

/s/
Leslie A. Sussan

/s/
Constance B. Tobias

/s/
Judith A. Ballard
Presiding Board Member