

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

Black River Area Development Corporation
Docket No. A-13-60
Decision No. 2532
September 3, 2013

DECISION

Black River Area Development Corporation (BRAD), an Arkansas-based non-profit community action agency, appeals a determination by the Administration for Children and Families (ACF) disallowing \$345,026.95 in federal funding provided to BRAD during the period September 2001 to June 2012 for Head Start and Early Head Start programs. BRAD agreed to repay ACF \$182,795.02 of the disallowance, but argues that there is insufficient evidence establishing that the remaining \$162,231.93 constitutes funds BRAD owes to ACF. For the reasons explained below, we uphold the disallowance in its entirety.

Case Background

BRAD has received Head Start/Early Head Start funding from ACF for several years. In mid-2012 BRAD discovered that its longtime chief financial officer (CFO) had been embezzling money from the organization. The CFO had written checks to herself from various BRAD checking accounts and then had altered BRAD's records to disguise the payments. As a result, BRAD repeatedly misreported its costs to ACF and other organizations from which it received funding.

After discovering the embezzlement, BRAD notified ACF and arranged for an independent audit to investigate the extent of the CFO's scheme. BRAD also terminated the CFO, who later pled guilty to mail fraud. The independent auditors determined that during the period September 2001 to June 5, 2012, the CFO embezzled a total of \$390,735.65 from BRAD. *See* ACF Ex. 9, at 10. BRAD subsequently determined and notified ACF that from September 2001 to April 2012, it had erroneously charged \$345,026.95 of that amount to its Head Start/Early Head Start grants as costs related to those programs.¹ ACF Ex. 3, at 3. Accordingly, by letter dated March 19, 2013, ACF notified BRAD that it was disallowing the \$345,026.95 as unallowable costs.

¹ BRAD also determined that it had erroneously received \$5,207.80 in Head Start/Early Head Start funding for May and June 2012 as a result of the CFO's scheme, but it refunded that amount to ACF. ACF Ex. 3, at 3.

BRAD repaid ACF \$182,795.02, but appealed to the Board regarding the remainder of the disallowance. BRAD maintains that it was able to verify based on original invoices and other documentation that the CFO's scheme led it to overstate its Head Start/Early Head Start costs in the amount of \$182,795.02 from January 2007 to April 2012. However, BRAD asserts that the remaining \$162,231.93 was derived from an analysis of transactions that took place from September 2001 to December 2006 for which there are no longer any underlying financial records, so it cannot substantiate that the \$162,231.93 actually represents funds it owes to ACF, as opposed to some other funding source.

Legal Background

Non-profit organizations that receive federal grants are subject to the cost principles in Office of Management and Budget (OMB) Circular A-122, now codified at 2 C.F.R. Part 230, and to the uniform administrative requirements at 45 C.F.R. Part 74. 45 C.F.R. §§ 74.1(a)(1), 74.27.

Under the cost principles, a cost is allowable under a federal award if, among other things, it is "reasonable for the performance of the award and . . . allocable thereto." 2 C.F.R. Part 230, App. A ¶ A.2.a. Costs also must be "adequately documented." *Id.* ¶ A.2.g. The Part 74 regulations require a grantee to have in place a financial management system that provides "[e]ffective control over and accountability for all funds, property and other assets." 45 C.F.R. § 74.21(b)(3). A grantee's financial management system also must provide "[r]ecords that identify adequately the source and application of funds for HHS-sponsored activities" and "[a]ccounting records, including cost accounting records, that are supported by source documentation." *Id.* § 74.21(b)(2), (7). With certain exceptions, a grantee must maintain financial records, supporting documents, and other records relevant to an award "for a period of three years from the date of submission of the final expenditure report or, for awards that are renewed quarterly or annually, from the date of the submission of the quarterly or annual financial report." *Id.* § 74.53(b).

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). Since the Board is "bound by all applicable laws and regulations" when reviewing a disallowance (45 C.F.R. § 16.14), where a disallowance is authorized by law and the grantee has not disproved its factual basis, the Board must affirm the disallowance. *Id.*

Analysis

BRAD asserts that ACF cannot disallow the \$162,231.93 at issue because there is insufficient evidence establishing that this portion of the money embezzled by the CFO is money that BRAD received from ACF. Indeed, BRAD says it "has always maintained

that the \$162,231.93 was embezzled but did not know exactly from where the funds originated.” BRAD Reply Br. at 1 (unnumbered page). BRAD’s contentions are undercut by documentation of several communications with ACF in which it repeatedly represented that it had successfully determined the amount of the embezzled funds traceable to Head Start/Early Head Start. In those communications, which we describe below, BRAD clearly represented that it owed ACF a total of \$345,026.95, which included the \$162,231.93 BRAD now claims is not owed ACF.

In early October 2012, BRAD’s Head Start Program Director stated in an email to an ACF Head Start Program Analyst that BRAD was progressing in its effort to “determine the allocation of embezzled funds.” ACF Ex. 5, at 6. The Program Director further stated that preliminary figures suggested the CFO had embezzled on average \$3,000 a year from a state-based grantor, “with the remainder coming from Head Start/Early Head Start.” *Id.* In mid-November 2012, the Program Director explained in an email to another ACF employee to whom she had previously provided the cumulative embezzlement figure of \$390,735.65 that this amount “is not the amount that is owed back to Head Start and Early Head Start. That amount is \$345,026.95 . . .” ACF Ex. 4, at 2 (emphasis added). The Program Director promised that BRAD would provide ACF “with the signed and more detailed report” regarding the amount of money owed to ACF by December 7, 2012. *Id.*

BRAD fulfilled that promise. In a letter to ACF dated December 6, 2012, BRAD stated that it had “completed its audit of funds owed to the Head Start/Early Head Start (HS/EHS) program due to misappropriation by the former Fiscal Officer.” ACF Ex. 3, at 2. The letter explained that it contained an attachment with an “analysis of the funds owed to the HS/EHS program,” which showed both the “total amount taken from HS/EHS funds” and the “method [the CFO] used to take these funds.” *Id.* According to these documents, the CFO “over-stat[ed] and over-allocat[ed] actual health insurance expenses and retirement benefit expenses to the [Head Start] program in the amount of \$182,795.02 from January 2007 to April 2012.” *Id.* In addition, from September 2001 to December 2006, the CFO wrote to herself and cashed a total of \$162,231.93 in checks that “were not authorized.” *Id.* at 2-3. Based on these figures, BRAD represented that it owed Head Start/Early Head Start a total of \$345,026.95. *Id.* at 3.

ACF reasonably relied on BRAD’s own calculations to determine the amount of the disallowance. Although BRAD now argues that the “calculated figure of \$162,231.93 is an estimate at best” that it derived “based on a formula suggested by a Region 6 ACF Office official” (BRAD Reply Br. at 1-2 (unnumbered pages)), BRAD does not explain why the use of any such formula was improper or untrustworthy, nor does it offer an alternative figure. Moreover, the documentation provided to the Board from the time period during which BRAD conducted its audit evinces no hesitation about the accuracy

of the figures that BRAD reported to ACF. To the contrary, the contemporaneous evidence shows that BRAD willingly and actively participated in determining that \$162,231.93 was the amount of ACF funds embezzled for the period September 2001 to December 2006.

The accounting firm that performed the independent audit of BRAD's books used procedures specifically agreed to by BRAD to prepare a report detailing the extent of the CFO's fraudulent scheme for ACF and other agencies that were impacted. *See* ACF Ex. 9, at 8. Those "agreed-upon" procedures included reviewing the checks written to and cashed by the CFO from September 2001 to December 2006. *See id.* at 10. Under those procedures, BRAD identified which checks were legitimate, and the accounting firm then subtracted the value of those legitimate checks from the total value of the checks to compute the value of the illegitimate checks. *Id.* at 21. The firm did not determine what portion of that figure was traceable to Head Start/Early Head Start, but BRAD subsequently did so through its own internal audit – and reported the \$162,231.93 figure to ACF. *See id.* at 10, 21; ACF Ex. 3, at 2-3.

BRAD now makes several arguments about why it is inappropriate for ACF to disallow the \$162,231.93. First, BRAD maintains that when it switched to new accounting software in September 2006, its prior financial records became unrecoverable. BRAD Br. at 2. It appears to assert that this software change explains why so many of the CFO's earlier checks were deemed unauthorized. *Id.* BRAD further argues that neither independent auditors who conducted yearly audits from 2001 to 2006 nor reviewers who conducted ACF's triennial reviews of BRAD's Head Start and Early Head Start programs in 2007 and 2011 found any problems with its finances. *Id.* at 3-4. Second, BRAD emphasizes that the unsupported transactions based on which it arrived at the \$162,231.93 figure all occurred beyond the three-year record retention window in 42 C.F.R. § 74.53. *Id.* at 4-5. BRAD argues that because the three-year record retention window closed before ACF questioned the \$162,231.93 in costs, ACF cannot fault it for failing to provide supporting documentation to prove the allowability of those costs. Third, BRAD stresses that it has taken several steps to improve its financial integrity, including instituting additional oversight across the board and segregating accounting and finance duties among different employees. *Id.* at 5-6. Further, BRAD asserts that the full disallowance will "financially hamper[]" it from "continuing to provide high quality Head Start and Early Head Start program services to the children and families of its service delivery area in the near and distant future." *Id.* at 6. It also argues that it relied on the positive reports that it received from its audits and triennial reviews, obtaining "assurances" about the integrity of its finances that "proved not to be completely reliable." *Id.*

BRAD's arguments are without merit and do not provide a basis for overturning or reducing the \$162,231.93 portion of the disallowance. Despite the changes in its accounting software and the closing of the three-year record retention window, BRAD produced a calculation of the amount of money that it owed ACF as a result of the CFO's scheme. As discussed above, ACF reasonably relied on that calculation to determine the amount of the disallowance.² In addition, while it is both commendable (and necessary) that BRAD has made an effort to ensure that no similar scheme to the CFO's embezzlement occurs, the Board does not have authority to reduce the amount of the disallowance on this basis. *See, e.g., Ga. Dep't of Human Servs., DAB No. 2309, at 22 (2010) (citing 45 C.F.R. § 16.14 and explaining that "the Board has no authority to reverse an agency's determination on equitable grounds")*. Similarly, neither the asserted likelihood that the disallowance will hamper BRAD's ability to continue serving Arkansas residents nor the fact that several reviews of its programs and finances failed to uncover the CFO's scheme provides a ground for reducing the disallowance.

Conclusion

For the foregoing reasons, we uphold the remaining \$162,231.93 portion of the \$345,026.95 disallowance in full.

/s/

Sheila Ann Hegy

/s/

Leslie A. Sussan

/s/

Stephen M. Godek
Presiding Board Member

² In light of ACF's reasonable reliance on the grantee's calculations, we need and do not decide here whether a grantee can legitimately rely on the records retention regulation as a defense to its failure to meet its well-settled legal obligation to account for its expenditure of federal funds.