Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Action for a Better Community, Inc.
Docket No. A-06-130
Decision No. 2104

DATE: August 7, 2007

DECISION

Action for a Better Community, Inc. (ABC) appealed a decision by the Administration for Children and Families (ACF) to disallow the expenditure by ABC of $906,745 in Head Start and Early Head Start grant funds. The disallowance relates to two grants, designated as grant number 02YC0325/05 and grant number 02CH0730/40.

ACF based the disallowance on three findings:

(1) ABC failed to document the expenditure of $204,174 in federal funds awarded for its “Our Market” project under Early Head Start grant number 02YC0325/05;

(2) ABC used $168,413 in federal funds awarded for the Our Market project to make building lease payments, payments not authorized under grant number 02YC0325/05; and

(3) During the period February 1, 2004 through April 30, 2005, ABC’s expenditure of federal funds under Head Start grant number 02CH0730/40 exceeded — by $534,158 – the amount that ACF had authorized ABC to spend during that period.

Because the record substantiates these three findings, we uphold the entire disallowance.

A. Background

ABC, a non-profit corporation, operates Head Start and Early Head Start programs in upstate New York.[1] The programs are funded largely with grants of federal financial assistance issued by ACF. See 45 C.F.R. Parts 1301-1302. Under a typical Head Start grant, ACF approves the grantee's program for a multi-year or indefinite "project period" but funds the program with discrete annual awards, with each award corresponding to a specified 12-month "budget period" (sometimes called a "funding period"). See ABC Ex. N; Central Piedmont Action Council, Inc., DAB No. 1916 (2004) (noting that a Head Start grantee "receives a discrete grant award for each program year"). The terms of an award are contained in (or attached to) a standard notice. See, e.g., ABC Ex. N. The standard award notice specifies the applicable budget period, the approved budget for that period (that is, a schedule of cost items and corresponding amounts to which the awarded federal funds may be applied), and other terms and conditions. Id.

Within 90 days after the end of a budget period, a grantee must submit a Financial Status Report (FSR), form SF-269, regarding its award for that period. 45 C.F.R. § 74.52(a)(1)(iv).[2] On the FSR, the grantee must report, among other things, the total amount of its grant-related "outlays" for the period in question. See, e.g., ABC Ex. M (line 10.a.). "Outlays" (a term synonymous with "expenditures" under the regulations) include cash disbursements or other expenses charged to the project or program for which the award was made. 45 C.F.R. § 74.2. The grantee must also report the amount of outlays financed with federal funds – that is the "federal share of net outlays." ABC Ex. M (line 10.j.).

Nonprofit organizations that receive federal Head Start funds are subject to Office of Management and Budget (OMB) Circular A-122,

[1] Head Start is a national program providing comprehensive developmental services, including health, nutritional, educational, social and other services, to economically disadvantaged preschool children and their families. 42 U.S.C. § 9831.

[2] The regulations at 45 C.F.R. Part 74 govern HHS awards of federal financial assistance to various types of entities, including non-profit organizations (like ABC). See 45 C.F.R. § 74.1.

Cost Principles for Non-Profit Organizations.[3] 45 C.F.R. § 74.27(a). The "cost principles" established in OMB Circular A-122 are used to determine whether, or to what extent, an organization's expenditures may be charged to — or deemed "allowable" under — a federal award. Id.; see also OMB Circular A-122, Att. A. To be "allowable" under an award, a cost or expense must, among other things, (1) "[c]onform to any limitations or exclusions set forth in [the applicable cost principles] or in the award as to types or amount of cost items"; and (2) "[b]e adequately documented."[4] OMB Circular A-122, Att. A, ¶ A.2.

1. *Grant Number 02YC0325/05 (Our Market Project)*

In 2002, ABC developed an interest in buying and renovating property on Hudson Avenue in Rochester, New York so that it could be used for Head Start and Early Head Start program activities. See ACF Ex. 9 (November 29, 2005 Report, Attachment 6). The planned purchase and renovation was known — and is referred to here – as the "Our Market" project.

In August 2002, ACF issued amendment two to Early Head Start grant number 02YC0325/05. ACF Ex. 1. Under this amendment, ACF awarded ABC $500,000 in "restricted" funds to help finance the purchase of the Our Market property on Hudson Avenue. Id. This award was subject to a "special condition," which was that ABC could not spend the $500,000 until it submitted and obtained ACF's approval of architectural specifications and other application material required by 45 C.F.R. § 1309.10.[5] Id.

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[3] OMB Circular A-122 was last revised on May 10, 2004. 69 Fed. Reg. 25,970 (May 10, 2004). Prior to 2004, the most recent substantive revision to the circular became effective on June 1, 1998. Vermont Slauson Economic Development Corp., DAB No. 1955, at 4 n.2 (2004); 63 Fed. Reg. 29,794 (June 1, 1998). The provisions of the circular that are relevant to this case have remained unchanged since at least June 1998. Our citations are to the most recent version of the circular.

[4] Costs must also be "allocable" to an award "in accordance with the relative benefits received." OMB Circular A-122, Att. A, ¶¶ A.2.a., A.4.

[5] In the letter that transmitted the relevant award notice, ACF informed ABC:

(continued...)

In December 2002, ABC executed a lease agreement with the owner of the Our Market Property, Carmen Irizarry. ABC Ex. B. The lease agreement permitted ABC to use the Our Market property for an initial term of 24 months in exchange for a monthly rent of $10,526. Id. at 1. The lease agreement gave ABC an option to purchase the property during the two-year lease term and further provided that ABC's lease payments would be applied to the total purchase price in the event that ABC exercised its option to purchase the property during that term. Id. at 1, 14-15. Along with the lease agreement, ABC simultaneously executed a Purchase and Sale contract in which it offered to purchase the Our Market property for $750,000, with $252,628 to be paid in 24 equal monthly "installments" of $10,526 and with the balance to be paid in a lump sum. ABC Ex. C.

As of April 30, 2003, the end of the budget and project periods for grant number 02YC0325/05, ABC had not met the special condition on use of the $500,000 awarded to purchase the Our Market property. Accordingly, on August 8, 2003, ABC submitted a FSR for grant number 02YCO325/05 that showed an "unobligated balance of federal funds" of $500,000 as of April 30, 2003. ACF Ex. 2.

In mid-August 2003, ABC provided ACF with a proposal to purchase and renovate the Our Market property. ACF Ex. 3. The proposal specified that federal dollars would be used to cover renovation costs, and that purchase of the property would be financed with a state grant and with proceeds of a bond issuance. Id. Based on this proposal, ABC submitted an Application for Federal Assistance (form 424) dated September 10, 2003. ACF Ex. 4.

ACF determined that the funding application and other material submitted by ABC during August and September 2003 satisfied the "special condition" contained in amendment two to grant number 02YC0325/05. ACF Exs. 5, 6. Accordingly, on October 20, 2003, ACF approved ABC's Our Market proposal and issued amendment three to grant number 02YC0325/05. Id. Amendment three extended the

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[5](...continued)

> The funds in the amount of $500,000 are restricted and may not be obligated pending your agency's submission and the Regional Office approval of the facility application that meets the requirements of 45 CFR § 1309.10 (subpart B – application procedures).

ACF Ex. 1.

budget and project period of the grant from April 30, 2003 to April 30, 2004. ACF Ex. 5. Amendment three also authorized an award of $500,000 "to complete the renovation" of the Our Market project. Id. at 2 & Attachment A (stating, in Attachment A, that the $500,000 grant award was for "the **major renovation** of the facility" (emphasis in original)).

In a letter transmitting grant amendment three, ACF informed ABC that "[t]he scope of the project approved by this office may not be changed, and the funds authorized may not be used for any other purpose without the prior written approval of the Regional Office." ACF Ex. 6. In addition, ACF directed ABC to report "one-time costs" of the Our Market project in box 12 of the final FSR for grant number 02YC0325/05. Id.

On March 30, 2004, one month before the end of the extended budget period, ABC's Finance Director, Kevin Mott, informed ACF in an email message that ABC had been unable to obtain all of the non-federal financing necessary to purchase the Our Market property. ACF Ex. 7. Mr. Mott suggested that this funding deficit could be closed by using $300,000 of the $500,000 in federal funds awarded under grant amendment three in order to close on the purchase. Id. Mr. Mott stated that approximately $200,000 of the $500,000 awarded under amendment three had already been spent on architectural fees and asbestos abatement. In addition, Mr. Mott acknowledged that ACF had taken the position that the remaining $300,000 "could not be reprogrammed beyond" April 30, 2004. Id.

There is no evidence that ACF ever authorized ABC to use the funds awarded under amendment three to purchase the Our Market property. Indeed, ABC admitted in late 2005 that it had been unable to locate evidence of an official request for such authorization. ACF Ex. 9 (November 29, 2005 Report, Attachment 6, pg. 2). In addition, there is no evidence that ABC asked ACF to extend the budget and project periods of grant number 02YC0325/05 beyond April 30, 2004.[6]

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[6] The record contains an April 21, 2004 letter to ACF from Loretta Scott, the Chair of ABC's Board of Directors. ACF Ex. 9 (November 29, 2005 Report, Attachment 6e). The letter states that the Board of Directors' executive committee had approved the purchase of the Our Market property, and that this approval was contingent on ACF permitting the use of remaining federal funds under grant number 02YC0325/05 to purchase the property. The letter also requested that the budget and project periods of the

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Between the spring of 2004 and the summer of 2005, ABC made additional but unsuccessful efforts to secure financing for the Our Market project. ACF Ex. 9 (November 29, 2005 Report, Attachment 6).

In November 2005, ABC issued a report that responded to concerns raised by ACF earlier that year about ABC's financial management and budgeting practices. ACF Ex. 9. One section of the report dealt with the Our Market project. According to the report, ACF had expressed concern that all $500,000 in federal Head Start funds awarded for renovation of the Our Market property had been spent even though ABC had not yet purchased the property. Id. (November 29, 2005 Report, Attachment 6, pgs. 1, 3). While ABC did not deny that all $500,000 had been spent, ABC expressed its continued interest in purchasing the property and outlined the efforts it was making toward that end. Id. ABC also provided a list of what it claimed were $528,890 of Our Market-related expenditures made between October 2003 and September 2005 with Head Start funds. Id. (November 29, 2005 Report, Attachment 6, pg. 3 & Attachment 6f). The expenditures on this list include 24 months of lease payments to Carmen Irizarry, the owner of the Our Market property. Id. (November 29, 2005 Report, Attachment 6f).

In December 2005, ABC's Board of Directors decided to abandon the Our Market project, concluding that it was financially infeasible. ACF Ex. 11. ABC then asked ACF to approve its use of federal funds for Our Market-related costs incurred prior to the decision to abandon the project. Id. In an email message dated June 21, 2006, ACF informed ABC that "[i]n order to make a final determination regarding the allowance of said costs," ABC needed to submit "copies of the payment documents reflecting the name of the vendor, amount paid, concept of payment, date of payment, and budget account charged for the payment." Id. In addition, ACF requested copies of the general ledgers in which Our Market expenditures were recorded. Id.

ABC responded to ACF's June 21, 2006 email message with a letter dated June 30, 2006. ABC Exs. G, S. This letter identified $295,825 in "costs incurred by ABC towards the Our Market project prior to determining that the project was no longer financially feasible." Id. These costs, for which ABC provided payment and

[6](...continued)
grant be extended to April 30, 2005. Id. The letter, however, is unsigned, and ABC admitted that it was never sent. Id.; ACF Ex. 9 (November 29, 2005 Report, Attachment 6, pg. 2).

other accounting records, were identified in the June 30th letter as follows:

$ 2900	Environmental research relating to consulting for air monitoring within the facility
24,000	Asbestos abatement within the facility to remove toxins
100,512	Design and construction development to ready the facility for use
168,413	*Lease to Own payments [from March 2003 through June 2004] . . .*
$295,825	Total spent prior to determining the project was not financially feasible.

Id. (italics added).

Upon receiving this itemization, ACF proceeded to determine whether the $500,000 in federal funds awarded under amendment three to grant number 02YC0325/05 had been spent on allowable costs. As noted earlier, ABC did not deny a statement by ACF that, as of late 2005, all $500,000 of these funds had been spent.

Based on its review of ABC's June 30, 2006 letter, ACF determined that $127,413 in Our Market expenditures for environmental research, asbestos abatement, and design and construction development were allowable under grant number 02YC0325/05.[7] ABC Ex. A at 2. However, ACF determined that $168,413 in lease payments to Carmen Irizzary were not allowable because they "were not approved by ACF as an activity of the grant award." Id. ACF also determined that $204,174 in expenditures – that is, the balance of expenditures made with award funds ($204,174 equals $500,000 minus $127,413 minus $168,413) – were not allowable because ABC had failed to document what they were made for. Id. at 3. In short, ACF disallowed $372,587 – that is, $204,174 for undocumented costs plus $168,413 for lease payments – in expenditures related to grant number 02YC0325/05. This determination was set forth in a notice of disallowance dated August 23, 2006. Id.

[7] The amounts reported for these three items in ABC's June 30, 2001 letter add up to $127,412, one dollar less than the amount deemed to be allowable by ACF. ABC Exs. A, G, F.

2. Grant Number 02CH0730/40

Grant number 02CH0730/40, as amended, authorized ABC to spend a total of $12,925,080 in federal funds for its Head Start and Early Head Start programs during the budget period February 1, 2004 through January 31, 2005.[8] ACF Ex. 12 (award amendment four, showing, in box 16, a "total approved budget" of $12,925,080).

In June 2005, ABC prepared a FSR for grant number 02CH0730/40. ABC Ex. O (at unnumbered page 4). This FSR – henceforth referred to as the June 2005 FSR – indicates that it covered the budget period February 1, 2004 through January 31, 2005, plus an additional three months until April 30, 2005. (ABC contends that the FSR covered these three additional months in order to account for the liquidation (payment) of obligations incurred during the budget period.[9] ABC Br. at 5 n.2.

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[8] Prior to February 1, 2004, ABC's Head Start and Early Head Start programs were funded under separate awards: ABC received federal funding for its Early Head Start program under grant number 02YC0325, and received funding for its Head Start program under grant number 02CH0730. See ABC Ex. N. Effective February 1, 2004, ABC received funding for both programs under grant number 02CH0730/40. Id. The record shows that the funds awarded under grant number 02CH0730/40 for the period February 1, 2004 through January 31, 2005 did not include funds for the renovation or purchase of the Our Market site. Id. When ACF issued grant number 02CH0730/40, ABC had already been awarded $500,000 for the Our Market project under amendment three to grant number 02YC0325/05, whose extended budget period ended on April 30, 2004. Although the budget periods of grant numbers 02CH0730/40 and 02YC0325/05 overlapped by three months (February 1 to April 30, 2004), there is no evidence that ACF transferred the residual spending authority under grant number 02YC0325/05 – namely, the authority to spend $500,000 to renovate the Our Market property – to grant number 02CH0730/40 or otherwise authorized ABC to spend those funds beyond April 30, 2004.

[9] See 45 C.F.R. §§ 74.71(b) (requiring a grantee to "liquidate all obligations under the award not later than 90 calendar days after the funding period or the date of completion as specified in the terms and conditions of the award or in agency implementing instructions"), 74.2 (defining "obligations" as "the amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period (continued...)

On line 10.p. of the June 2005 FSR, ABC reported the "unobligated balance of federal funds" for grant number 02CH0730/40. ABC Ex. O. The unobligated balance is the amount of federal funds that the HHS awarding agency authorized the grantee to obligate (pay or assume an obligation to pay) during the funding period but that remain unobligated at the end of that period.[10] 45 C.F.R. § 74.2 (definitions of "obligations" and "unobligated balance"). On the June 2005 FSR, ABC reported a *negative* unobligated balance of $534,158, meaning that the amount of federal funds expended for the period February 1, 2004 through April 30, 2005 exceeded the amount of federal funds that ABC was authorized to spend for the programs supported by grant number 02CH0730/40. Id.

In a May 31, 2005 email message, ABC's Chief Financial Officer, Todd Humphrey, confirmed that ABC had overspent the approved budget under grant number 02CH0730/40 by $534,158.[11] ACF Ex. 13. Mr. Humphrey also confirmed that $177,186 of the excess expenditures were for "accrued expenses" (such as earned vacation leave) and that the remaining $357,000 in expenditures had been made with federal funds drawn from a later (post-January 2005) budget period. Id.

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[9](...continued) that require payment by the recipient during the same or a future period").

[10] The unobligated balance of federal funds (FSR line 10.p.) is calculated by subtracting the amount reported as the federal share of net outlays and unliquidated obligations (FSR line 10.n.) from the amount of federal funds authorized for the funding period (FSR line 10.o.). See ABC Ex. O. In other words, "federal funds authorized" minus the federal share of outlays and unliquidated obligations equals the "unobligated balance of federal funds." The June 2005 FSR indicates that the amount of federal funds authorized for the relevant funding or budget period (February 1, 2004 to January 31, 2005) was $12,925,080, and that the federal share of net outlays and unliquidated obligations was $13,459,238 — $534,158 more than the amount of federal funds authorized. Id.

[11] The email message states that the overexpenditure was $534,186 — $28 more than was reported on the June 2005 ($534,158). For purposes of this decision, this discrepancy is immaterial because ACF disallowed only $534,158 and has not asked us to increase the disallowance.

On September 27, 2005 ACF asked ABC to refund $534,158. ACF Ex. 17. ABC countered with a proposal to repay this amount over a ten-year period. ACF Ex. 18. ABC did not accept this proposal. Instead, in its August 23, 2006 notice of disallowance, ACF informed ABC that it was disallowing $534,158, which, as indicated, is the amount by which ABC's expenditures of federal Head Start funds between February 1, 2004 and April 30, 2005 exceeded that period's approved budget under grant number 02CH0730/40. ABC Ex. A. ACF determined that "the expenditure of these excess funds was not authorized under the approved grant award and did not conform to the limitations contained in the grant award." Id. at 2. ACF also determined that the excess expenditure could not be charged to any previous or subsequent Head Start or Early Head Start grant. Id.

B. Discussion

ABC contends that the disallowance should be overturned, asserting that it was "based on flawed information and/or a misunderstanding of the relevant cost principles." ABC Br. at 4. On the contrary, we find that the record substantiates the findings that support the disallowance, and the disallowance is consistent with the applicable cost principles.

1. *ACF properly disallowed $372,587 of expenditures made with federal Head Start funds provided under grant number 02YCO325/05.*

As outlined above, in October 2003, ACF issued amendment three to grant number 02YC0325/05. This amendment authorized ABC to spend $500,000 in federal funds for the renovation of the Our Market property. The amendment also extended the budget and project periods of the grant from April 30, 2003 to April 30, 2004. ABC does not dispute that it expended the $500,000 awarded under grant number 02YC0325/05. Indeed, it has submitted with its reply brief a revised final FSR for grant number 02YC0325/05 showing that all funds awarded under that grant, including the $500,000 earmarked for the Our Market project, were spent (and charged to the grant). ABC Ex. M (see the first document in that exhibit, showing an unobligated balance of federal funds of zero); compare ACF Ex. 2 (the original FSR for grant number 02YC0325/05, submitted to ACF in August 2003, showing an unobligated balance of $500,000).

The issue here, then, is whether the costs for which ABC expended the $500,000 awarded under grant number 02YC0325/05 were allowable.

a. Lease payments of $168,413 were unallowable under grant number 02YC0325/05.

ACF determined that $168,413 of the $500,000 in federal funds awarded to ABC had been expended for lease payments that were not allowable under grant number 02YC0325/05. ABC now contends that the lease payments it made between March 2003 and June 2004 were allowable because the grant authorized expenditures to purchase the Our Market property. ABC Br. at 8. In support of that contention, ABC asserts that, under its December 2002 Purchase and Sale Contract, the lease payments constituted "installment payments" on the purchase price of the Our Market property and as such should be regarded as expenditures under a "capital lease" — that is, expenditures to purchase a capital asset. Id. at 7-8 (citing provisions of OMB Circular A-122 which recognize a "capital lease" as a method of purchasing land, buildings, or other capital assets and permits a grantee to charge interest on a capital lease as an acquisition cost). In addition, ABC asserts that the Purchase and Sale Contract was included in its Head Start funding application for the Our Market project that ACF approved in October 2003. Id. at 7.

The basic problem with this argument is that, even if the lease payments could be regarded as costs of purchasing the Our Market property, and we make no finding that they could be,[12] the payments plainly violated the terms and conditions of the grant. Amendment two to grant 02YC0325/05 did, in fact, authorize ABC to spend $500,000 in federal funds to purchase the Our Market property. But the grant expressly precluded ABC from using the funds until it met the special condition requiring it to furnish and obtain ACF's approval of architectural plans and other application materials required by 45 C.F.R. § 1309.10. ABC failed to meet this special condition by April 30, 2003, the end of the budget period associated with amendment two. Consequently, any expenditures of these funds prior to April 30, 2003 – and, for that matter, any expenditures prior to October 2003, when ACF finally determined that ABC had met amendment two's special condition — violated the grant's terms and

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[12] Whether the lease payments qualified as "purchase" costs arguably depends on whether the underlying transaction qualified as a "purchase" under 45 C.F.R. Part 1309, which prescribes procedures for applying for Head Start grant funds to purchase, construct, or make major renovations to facilities in which to operate Head Start programs as authorized by 42 U.S.C. § 9839(g).

conditions and were thus unallowable.[13] OMB Circular A-122, Att. A, ¶ A.2 (providing that a cost or expense is allowable only if it conforms to limitations set in the award as to the type or amount of cost items).

When ABC finally met the special condition in October 2003, the grant no longer authorized ABC to use federal funds to purchase the Our Market property. The October 20, 2003 award notice for amendment three to grant number 02YC0325/05 informed ABC that it had met the special condition imposed by amendment two, and that amendment three "authorize[d] the obligation of the $500,000 included in grant award amendment #2 <u>to complete the renovation</u> project at 1109-1121 Hudson Avenue." ACF Ex. 5, at 2 (emphasis added).

ABC asserts that amendment three also authorized it to use federal funds to purchase the Our Market property. Reply Br. at 3. It points to page one of the October 20, 2003 award notice, which states in part:

> Cost under the line item 'Facilities/Construction' are to be used as described in the grantee's application for the following: <u>Facility Purchase Amount $500,000</u>; Major Renovation Amount $0; and Construction Amount $0 . . . .

ACF Ex. 5 (emphasis added). From reading the entire award notice, it is clear that the underlined words in the above-quoted passage are a typographical error. Page two of the award notice states that "[t]his grant action authorizes the obligation of the $500,000 included in grant award amendment #2 to <u>complete the renovation project</u>[.]" <u>Id.</u> (emphasis added). Attachment A to the award notice, entitled "Special Conditions for Construction, Major Renovation, or Purchase of a Head Start Facility," and whose provisions were expressly made applicable to ABC's project, states that the "agreement between the [ACF and ABC] includes the

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[13] The record shows that ABC made lease payments for March and April 2003, and ABC identifies those payments as allowable under grant number 02YC0235/05. ABC Ex. S. Whether these payments were made with federal funds is unclear. The payments were made during the budget period covered by amendment two to grant number 02YC0235/05. That budget period ended on April 30, 2003. The original FSR for that budget period (submitted in August 2003) indicates that none of the $500,000 awarded for Our Market acquisition costs had been obligated. ACF Ex. 2.

awarding of $500,000 in one-time Federal funds towards the **major renovation** of the facility." Id. (emphasis in original).

Other portions of the record confirm that the October 2003 award notice authorized expenditures for renovation only. Immediately after the above-quoted passage, the award notice states that amendment three "extends the budget and project period through April 30, 2004 to complete the purchase and renovation facility project based on the grantee's facility application proposal dated 9/10/03." Id. (emphasis added). The budget summary attached to ABC's September 10, 2003 funding application makes no mention of federal funds being used for purchase costs. Instead, it indicates that $500,000 in federal funds would be allocated to "contractual" and "construction" activities. ACF Ex. 4 (Section A Budget Summary, column c). In addition, the project proposal on which the funding application was based provides that non-federal funds would be used to purchase the Our Market property. That proposal was set out in Exhibits A and B to an August 14, 2003 letter from ABC to ACF. See ACF Ex. 3. Exhibit A indicates that the federal funds of $500,000 would be used to pay for "Renovations," while the "Purchase Price" of $750,000 would be paid with proceeds from a bond issuance. Id. Exhibit B details the renovation-related costs that would be paid for with the "Federal One-Time" award of $500,000.[14] Id.

Post-award correspondence provides additional confirmation of the award terms. The March 2004 email message by ABC's Finance Director (ACF Ex. 7) suggesting that ACF should permit the use of $300,000 in funds awarded under amendment three to close on the purchase of the Our Market property is an implicit acknowledgment that ABC understood amendment three to authorize the use of federal funds for renovation only.

In short, at no point between March 2003 and June 2004, when the disputed lease payments were made, did grant number 02YC0325/05 authorize ABC to make those payments, either because the special condition imposed by grant amendment two had not been satisfied, or because the grant, as amended in October 2003, authorized only renovation expenditures. There is no evidence that, after it approved amendment three, ACF authorized ABC to use the funds awarded under grant number 02YC0325/05 for lease payments of any

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[14] These costs were identified as: General Contractor, Site Work & Prep, Architectural, Appraisal, Site Analysis, Environmental, Asbestos Abatement, and Playground. ACF Ex. 3 (Exhibit B).

kind. For these reasons, we conclude that ABC's lease payments were properly disallowed.

b. <u>ABC failed to document how $204,174 in federal funds awarded for the Our Market project were expended</u>.

In response to ACF's June 2006 request for documentation of its Our Market expenditures, ABC produced source documentation (e.g., cancelled checks, accounting records) for only $295,825 of those expenditures, including the unallowable lease payments of $168,413. ABC Exs. G, S. Because ABC claims to have spent all $500,000 awarded for the Our Market project under grant number 02YC0325/05, it needed to account for an additional $204,174 in expenditures ($500,000 minus $295,825). ACF determined that ABC had failed to document these additional expenditures and accordingly disallowed them.

When a cost is disallowed by the grantor agency, the burden is on the grantee to prove, with appropriate documentation, that the cost is allowable under the cost principles and other relevant program requirements. <u>Marie Detty Youth and Family Services Center, Inc.</u>, DAB No. 2024 (2006) (noting that it is a "fundamental principle of grants management that a grantee is required to document its costs"); <u>Northstar Youth Services</u>, DAB No. 1884 (2003) ("Once a cost is questioned as lacking documentation, the grantee bears the burden to document, with records supported by source documentation, that the costs were actually incurred and represent allowable costs, allocable to the grant"); 45 C.F.R. §§ 74.21(b)(2), (b)(7) (requiring a grantee to have in place a financial management system that provides "[r]ecords that identify adequately the source and application of federal funds" as well as "[a]ccounting records . . . that are supported by source documentation"). ABC clearly has not met its burden of documenting the existence or allowability of $204,174 in Head Start expenditures under grant number 02YC0325/05. It has produced no accounting records or source documentation verifying the existence of those expenditures. It has also failed to allege or show that the expenditures, assuming they were made, satisfied the terms and conditions of the grant and were otherwise allowable. <u>See</u> ABC Br. at 8-9; Reply Br. at 4.

ABC claims that the chart it prepared in late 2005 listing $528,890 of Our Market expenditures as of September 16, 2005 – <u>see</u> ABC Ex. F — constitutes adequate documentation of its grant-related expenditures. ABC Br. at 9. This chart does not purport to be an accounting record. Even assuming that the chart is based on accounting and other financial records, ABC failed to provide such records for $204,174 of the listed expenditures. Moreover, most of those expenditures — for utilities, taxes, building maintenance, lease payments — are clearly unallowable under grant number 02YC0325/05, either because they were made for unauthorized purposes (e.g., lease payments, building maintenance), or because they were made after April 30, 2004, the end of the applicable budget period. 45 C.F.R. § 74.28 (providing that when a funding period is specified in a grant award, "a recipient may charge to the award only allowable costs resulting from obligations incurred during the funding period"); Marie Detty Youth and Family Services Center, Inc. at 38 ("Even where ACF finds costs allowable . . . costs are still subject to disallowance if they arose in a program year other than the one covered by the grant award"). As we noted earlier, ABC has made no attempt to show that the undocumented expenditures met the terms and condition of grant number 02YC0325/05. For these reasons, we affirm the disallowance of $204,174.[15]

2. ACF properly disallowed $534,158 in expenditures charged to grant number 02CH0730/40.

As indicated, ACF's disallowance of $534,158 is based on the June 2005 FSR. The June 2005 FSR, which relates to grant number 02CH0730/40 and covers the period from February 1, 2004 through April 30, 2005, indicates that:

- net "outlays" (amounts expended and charged to the grant) were $17,921,083 (line 10.d.);
- the federal share of net outlays and unliquidated obligations was $13,459,238 (lines 10.n and 10.j.); and
- federal funds authorized for the applicable budget period (February 1, 2004 to January 31, 2005) were $12,925,080 (line 10.o.).

[15] In its reply brief, ABC contends that adequate source documentation can be found in the material attached to its June 30, 2006 letter. Reply Br. at 4. However, that documentation relates only to the $127,413 in expenditures that ACF determined to be allowable, and to the $168,413 in lease payments that we have determined to be unallowable. The letter contains no documentation showing how the balance of the awarded funds — $204,174 — was spent.

ABC Ex. O. As a result of these entries, the June 2005 FSR shows a negative "unobligated balance of federal funds" of $534,158 (line 10.p.), meaning that the federal share of net outlays charged to grant number 02CH0730/40 exceeded – by $534,158 – the federal funds authorized to be spent during the applicable period. Id. ABC's chief executive officer signed and certified the June 2005 FSR as being "correct and complete." Id.

Notwithstanding this certification,[16] ABC now contends that there was, in fact, no overexpenditure of federal funds under grant number 02CH0730/40 during the period February 1, 2004 through April 30, 2005. ABC contends on appeal that a "reconciliation" of its Head Start and Early Head Start expenditures for that period reveals the following:

> [T]he deficit and/or overdraw appearing on the June 2, 2005 final FSR stems from the fact that (1) ACF issued an amendment to ABC's award in October 2003 [under grant number 02YC0325/05] . . . to allow for the carryover [of] $500,000 in one-time program improvement funds to assist in the development of the "Our Market" project and to extend the period of availability of funds to April 30, 2004, and (2) the June 2, 2005 final FSR for the period comprising February 1, 2004 through April 30, 2005 mistakenly included expenditures out of the carryover funds for both the period reported and the previous budget period and did not include an identification of the carryover authorized for obligation during that period. In other words, because of the overlap in the budget periods [February 1, 2004 to April 30, 2004], the final FSR [for grant number 02CH0730/40] showed costs charged during the budget period reported that were not, in fact, paid out of the award for that budget period, but instead were paid as authorized in the October 2003 award amendment.

ABC Br. at 6. In essence, ABC contends that the June 2005 FSR showed an overexpenditure of federal funds for the period February 1, 2004 through April 30, 2005 under grant number 02CH0730/40 because: (1) the amount reported on line 10.j. as the federal share of net outlays – $13,459,238 – included expenditures authorized for the Our Market project under grant

[16] The standard form FSR requires the grantee to certify that the "report is correct and complete and that all outlays and unliquidated obligations are for the purposes set forth in the award documents." See, e.g., ABC Ex. M.

number 02YC0325/05; and (2) the amount reported as the total federal funds authorized under grant number 02CH0730/40 — $12,925,080 — did not include the $500,000 in funds awarded for the Our Market project under grant number 02YC0325/05.

In support of this contention, ABC submitted a revised but unsigned FSR for grant number 02CH0730/40 that, like the June 2005 FSR, covers the period from February 1, 2004 through April 30, 2005.[17] ABC Ex. M (at unnumbered page 2). The revised FSR reported:

- net outlays of $17,392,193 — $528,890 less than reported on the June 2005 FSR;
- federal share of net outlays of $12,795,166 — $664,072 less than reported on the June 2005 FSR;
- federal funds authorized of $12,925,080 — the same as earlier reported; and
- a *positive* unobligated balance of federal funds of $129,914, rather than a negative balance of $534,158.

Id. According to ABC, these revised totals "derive[] from ABC's reconciliation of costs of operating its Head Start and Early Head Start programs for February 1, 2004 through January 31, 2005 to exclude the sums properly obligated and spent out of carryover funds authorized through April 30, 2004." ABC Br. at 6.

ABC also submitted, as an exhibit to its reply brief, what purports to be a revised or updated FSR for grant number 02YC0325/05. ABC Ex. M (unnumbered page 1). This revised FSR — also unsigned, undated, and uncertified — indicates that: (1) federal funds authorized for the period May 1, 2002 through April 30, 2004 were $3,023,381 (line 10.o.), an amount that includes the $500,000 awarded for the Our Market project; (2) the federal share

[17] ABC actually submitted two versions of a revised FSR for grant number 02CH0730/40. The first version, ABC Exhibit J, shows an unobligated balance of federal funds of $140,439. The second version, ABC Exhibit M, shows an unobligated balance of federal funds of $129,914. The second version indicates, in box two, that the FSR relates to grant number 02YC0325/05, an apparent typographical error. For discussion purposes, we cite and refer to the revised FSR for grant number 02CH0730/40 as it appears in ABC Exhibit M.

of net outlays was $3,023,381 (line 10.j.); and (3) the unobligated balance of federal funds was zero, an indication that all federal funds awarded under grant number 02YC0325/05 had been expended and charged to the grant. Id.

In addition, ABC submitted (with its initial brief) a November 16, 2006 opinion letter from the accounting firm, Heveron & Heveron, that had audited ABC's financial position in accordance with the Single Audit Act (SAA).[18] ABC Ex. K. The opinion letter states that the accountants had "audited the amounts reported on line J" of the revised FSRs — that is, the amounts reported on line 10.j. as the "federal share of net outlays" — for grant numbers 02CH0730/40 and 02YC0325/05. Id. The letter further states that these FSRs were prepared by ABC, and that the accountants' "responsibility was to express an opinion on these amounts [on line 10.j.] based on [its] audit." Id. The letter then states that "line [10.j.] of revised forms 269 Financial Status Reports . . . present fairly, in all material respects the total federal share of net outlays in conformity with accounting principles required for the Financial Status Report." Id.

In its response brief, ACF asserted that ABC had failed to submit sufficient evidence — such as accounting and other financial records — to support its claim that Our Market expenditures had been mistakenly reported as outlays on the June 2005 FSR or the related claim, arising from its accountants' November 2006 opinion letter, that the revised FSRs reflected a true and accurate accounting of expenditures under grant numbers 02CH0730/40 and 02YC0325/05. In response, ABC submitted, as exhibits to its reply brief, what it called the "working papers underlying" the accountants' November 2006 opinion letter. See Reply Br. at 3. These materials include:

- ABC Exhibit L — a "position memo" prepared by ABC's chief financial officer that purports to show a "reconciliation" of (a) ABC's Head Start and other federally-assisted program expenditures for 2004 and 2005, and (b) ABC's drawdown of

[18] The Single Audit Act requires a non-federal entity (such as a non-profit organization) that spends more than $300,000 in federal grant funds during a fiscal year to conduct a single, comprehensive financial and compliance audit of its programs for that year. 31 U.S.C. 7502(a)(1)(A); OMB Circular A-133. In accordance with that requirement, Heveron & Heveron performed a financial and compliance audit of ABC for the fiscal year ending September 30, 2004. ACF Ex. 14.

federal funds from HHS's Payment Management System" (PMS);

- ABC Exhibit P — a chart summarizing the results of the reconciliation discussed in the position memo;

- ABC Exhibit N — copies of relevant grant award notices;

- ABC Exhibit Q — a summary of ABC's PMS drawdowns from February 1, 2004 through April 30, 2005; and

- ABC Exhibit R — summaries of cash disbursements to vendors under ABC's federally-assisted programs from February 1, 2004 through April 30, 2005.

According to ABC, these additional materials confirm that Our Market project expenditures under grant number 02YC0325/05 were mistakenly included in the amount reported as the federal share of net outlays on the June 2005 FSR, and that there was no overexpenditure of federal grant funds by ABC in the period from February 1, 2004 through April 30, 2005. Reply Br. at 2.

If it is true that ABC reported its Our Market expenditures as outlays in the June 2005 FSR without also reporting the federal funds awarded for those expenditures, then it is conceivable that certain expenditures were disallowed twice — first because they were determined to be unallowable under grant number 02YC0325/05 (see the previous section of the discussion), and second because they contributed to the reporting of an overexpenditure on the June 2005 FSR for grant number 02CH0730/40. For several reasons, however, we find that ABC has failed to meet its burden of proving that Our Market expenditures were erroneously reported as outlays on the June 2005 FSR.

In an attempt to meet its burden, ABC asks that we accept as accurate two FSRs that were submitted for the first time in this appeal: a revised FSR for grant number 02CH0730/40, and a revised FSR for grant number 02YC0325/05. ABC Ex. M.[19] Neither is dated, signed, or certified, whereas the June 2005 FSR is signed, dated, and certified as "correct and complete." We give more weight to the signed, dated, and certified FSR absent clear

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[19] As indicated, ABC represents that ABC Exhibit M (unnumbered page 1) is the revised final FSR for grant number 02CH0730/40, even though box two on this document indicates that it relates to grant number 02YC0325/05.

evidence that the document is not correct or complete. As the discussion in this section makes clear, ABC failed to present such evidence.

We give little weight as well to the opinion letter from ABC's accountants. That letter states that the revised FSRs "present fairly, in all material respects the total federal share of net outlays in conformity with accounting principles required for the Federal Status Report." ABC Ex. K. However, the accountants failed to describe the evidence and analysis supporting their opinion. ABC claims that the exhibits attached to its reply brief, ABC Exhibits L through S, constitute the "working papers" underlying the auditors' opinion. Reply Br. at 2. But ACF questioned that representation, Surreply Br. at 2, and there are no statements or other evidence that the so-called working papers were a basis for, or related to, the accountants' November 2006 opinion regarding the revised FSRs.

The more fundamental problem is that these exhibits fail to confirm ABC's assertion that Our Market expenditures were erroneously included in the amount reported on line 10.j. of the June 2005 FSR as the federal share of net outlays. The "position memo" prepared by ABC's chief financial officer is focused not on proving that the June 2005 FSR inaccurately reported net outlays for grant number 02CH0730/40 but instead on showing that: (1) "ABC did not draw federal funds in excess of federal awards" between February 1, 2004 and April 30, 2005; and (2) there were "sufficient federal dollars remaining in the PMS [Payment Management System] to operate all federal awards." ABC Ex. L at 2; ABC Ex. P. We cannot discern, and ABC does not explain (in its brief or in the position memo), how or why this "reconciliation" necessarily proves that Our Market expenditures were included in the amount of outlays reported on the June 2005 FSR.

The reconciliation was not supported by adequate documentation in any event. According to ABC, during the period covered by the June 2005 FSR – February 1, 2004 to April 30, 2005 – ABC's drawdown of federal funds for all of its federally-supported programs (including Head Start and other activities funded by the Centers for Disease Control and HHS's Office of Community Services) did not exceed ABC's reported expenditures of federal funds for that period. This claim is reflected on a chart that lists ABC's expenditures for each of its federal grant programs for the period February 1, 2004 to April 30, 2005. ABC Ex. P. However, in some instances, documentation for the expenditures is lacking. For example, the chart indicates that $2,910,295 in federal funds were expended under grant number 02CH0730/41 (the award subsequent to grant number 02CH0730/41) for the period February 1, 2005 through April 30, 2005. Id. (column 4). ABC provided no documentation (e.g., FSRs, accounting records) verifying that these expenditures were actually made and properly charged to that grant for the period in question. In addition, the chart inexplicably includes $618,287 in expenditures under a grant – number 02CH0730/39 – whose budget and project period ended *prior to* the period covered by the June 2005 FSR. See ABC Ex. P (column 1); ABC Ex. N (notice of award under grant number 02CH0730/39, showing a budget period ending on January 31, 2004).[20]

To support properly its claim that the overexpenditure shown on the June 2005 FSR was a reporting error, ABC needed to produce (among other things) accounting records, workpapers, or other evidence that specifically identified the outlays included in the amount reported as the federal share of net outlays in the June 2005 FSR. The material that ABC furnished to support its purported reconciliation contains no such accounting records.

ABC Exhibit R contains summaries of what ABC says are its cash disbursements for all of its federal awards for the period from February 2004 to April 2005. Reply Br. at 2. These summaries show ABC's expenditures under different "contract numbers," with each contract number corresponding to a specific grant. For example, the contract number associated with grant number 02CH0730/40 – to which the June 2005 FSR relates – is 4215.[21] ABC Ex. P (column 3).

Two things are noteworthy about Exhibit R. First, the cash disbursement summaries, which appear to be drawn directly from ABC's accounting system, document only $4,344,642.91 in expenditures for grant number 02CH0730/40, far less than the amount reported as the federal share of net outlays in the June 2005 FSR ($13,459,238). Second, these summaries suggest that Our Market expenditures were not included in the outlays reported on

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[20] ABC made no attempt to reconcile its presentation with the findings of the SAA audit. That audit found that, for the period ending September 31, 2004, ABC "received approximately $567,000 of advance payments in excess of total approved contract awards." ACF Ex. 14, at 18.

[21] The cash disbursement summary for grant number 02CH0730/40 (contract number 4215) indicates that it includes checks posted from January 2004 through April 2005, not February 2004 through April 2005, as alleged by ABC. Reply Br. at 2.

the June 2005 FSR. The summaries identify $215,827 in Our Market expenditures using two contract numbers – 7594 and 7595. According to a chart that summarizes ABC's "reconciliation" of expenditures and PMS drawdowns, 7594 and 7595 are the contract numbers associated with grant number 02YC0325/05. See ABC Ex. P (column 2). ABC has not pointed us to any cash disbursements related to the Our Market project that were recorded in its accounting records under the contract number associated with grant number 02CH0730/40. Moreover, we see no evidence that ABC allocated Our Market expenditures to grant number 02CH0730/40 for internal accounting or financial reporting purposes.

We find ABC's presentation unpersuasive for a number of other reasons. First, ABC's current explanation for the reported overexpenditure – that it mistakenly included Our Market expenditures in the total outlays reported on the June 2005 FSR – is at odds with the explanation that ABC gave prior to initiating this appeal. On May 24, 2005, ABC's chief financial officer reported that the overexpenditure reflected $177,186 in accrued expenses, with the remaining amount, about $357,000, reflecting a draw-down of federal funds from the "current budget period" (presumably, the budget period beginning February 1, 2005) in order to cover an "over-expenditure from 1/31/05." CMS Ex. 13, at 2. ABC has made no attempt to reconcile these apparently inconsistent explanations or demonstrate that the explanation proffered to ACF on May 24, 2005 was erroneous.

Second, ABC has failed to explain why the alleged reporting error occurred, and we find it difficult to imagine the reasons for it.[22] The federal funds expended for the Our Market project were awarded under grant number 02YC0325/05, whose budget and project periods ended on April 30, 2004. The June 2005 FSR indicates on

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[22] ABC suggests that the mistake occurred because the two grants – 02CH0730/40 and 02YC0325/05 – had overlapping budget periods. However, ABC presented no evidence that this was the actual reason for the alleged error. Furthermore, there was only a three-month overlap in the budget periods: February 1 to April 30, 2004. Even if the overlap provided justification for the inclusion of Our Market expenditures on the June 2005 FSR (and it did not), that justification would have permitted ABC to include only those expenditures made between February 1 and April 30, 2004. ABC does not claim to have spent or obligated all $500,000 for the Our Market project during that period, and the available evidence indicates that ABC's Our Market expenditures between February 1 and April 30, 2004 were considerably less than $500,000. See ABC Exs. G, S.

its face that it dealt with federal funds awarded under an entirely separate grant — grant number 02CH0730/40 – that did not authorize spending on the Our Market project and that covered a period ending one year after the close of the funding period for grant number 02YC0325/05. Approximately two years before submitting the June 2005 FSR, ABC submitted a FSR for grant number 02YC0325/05 that accounted for the $500,000 awarded for the Our Market project. ACF Ex. 2. Furthermore, in October 2003, when ACF authorized the use of $500,000 to renovate the Our Market property, ACF expressly instructed ABC to report its use of those funds in box 12 of the final FSR for grant number 02YC0325/05. See ACF Ex. 6 (letter transmitting amendment three to grant number 02YC0325/05). This is evidence that ABC, an experienced federal grantee with officers presumably familiar with federal financial reporting requirements, knew it had to report the use of these funds separately from the use of funds provided under different awards. We simply do not understand why ABC would have included Our Market expenditures in the June 2005 FSR when the correct approach — to account for these expenditures separately in the FSR for grant number 02YC0325/05 — would have avoided the reporting of an overexpenditure and resulting disallowance. Under the circumstances, we do not find credible ABC's claim that it reported Our Market expenditures in the June 2005 FSR.

Finally, although ABC contends that it reported in excess of $500,000 in Our Market expenditures on the June 2005 FSR, it has produced documentary evidence of only $295,825 of those expenditures ($168,413 of lease payments and $127,412 for architectural, environmental, and design and construction costs). See ABC Ex. S. We cannot find that certain expenditures were included in outlays reported on a FSR when the existence of those expenditures has not even been verified by appropriate accounting records and source documentation.

In short, ABC has failed to produce a trail of accounting and other records confirming that $500,000 in Our Market expenditures were mistakenly included in the amount reported on the June 2005 FSR as the federal share of net outlays. For this reason, we conclude that, for the period February 1, 2004 through April 30, 2005, ABC's expenditures of federal funds exceeded the amount authorized for that period by $534,158. Expenditures in excess of the amount authorized under a grant are unallowable. Rhode Island Substance Abuse Task Force Assoc., DAB No. 1742 (2000).

Conclusion

For the reasons discussed, we affirm ACF's decision to disallow ABC's expenditure of $906,745 in federal Head Start and Early Head Start grant funds.

/s/
Constance B. Tobias

/s/
Leslie A. Sussan

/s/
Sheila Ann Hegy
Presiding Board Member