Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Teaching and Mentoring Communities, Inc.
Docket No. A-14-75
Decision No. 2636
May 12, 2015

DECISION

Teaching and Mentoring Communities, Inc. (TMC), a non-profit corporation, operates Head Start and Migrant and Seasonal Head Start programs that serve children and their families in several states. These programs are financed with grants issued by the Administration for Children and Families (ACF) under the federal Head Start Act, 42 U.S.C. § 9831, *et seq.*

An auditor retained by ACF examined TMC's use of a cost pool to account for and allocate costs of risk management to its grant-financed programs. The auditor found that TMC's use of the cost pool resulted in its Head Start Migrant and Seasonal Head Start grants being charged $811,572 in violation of the cost principles in Office of Management and Budget (OMB) Circular A-122. ACF concurred with the auditor's findings and therefore disallowed TMC's use of $811,572 in federal grant funds. TMC appeals the disallowance, contending that ACF has not articulated legally sufficient grounds for that action.

As explained below, we affirm the disallowance in its entirety.

I. <u>Legal Background</u>

Non-profit organizations that receive federal Head Start funds are subject to OMB Circular A-122, titled "Cost Principles for Non-Profit Organizations."[1] 45 C.F.R.

[1] The disallowance concerns costs that were charged to TMC's grants between 2010 and 2013. During that period, OMB Circular A-122 was codified – in its entirety and format – in Appendix A of 2 C.F.R. Part 230. *See* 70 Fed. Reg. 51,910 (Aug. 31, 2005); 2 C.F.R. Part 230 (Jan. 1, 2013). This decision cites to, and quotes from, that codification. In December 2013, the OMB consolidated the content of OMB Circular A-122 and eight other OMB circulars into one streamlined set of uniform administrative requirements, costs principles, and audit requirements for federal awards, currently published in 2 C.F.R. Part 200. 78 Fed. Reg. 78,590 (Dec. 26, 2013).

§ 74.27(a) (Oct. 1, 2013).[2] The cost principles in OMB Circular A-122 govern whether or to what extent a non-profit organization's "costs" are "allowable" under (that is, may be charged to) a grant or other federal "award." 2 C.F.R. § 230.20(a) (Jan. 1, 2013). (In accounting parlance, a "cost" is the "monetary value of resources used."[3])

In order to be allowable, a grantee's costs must meet various general criteria. 2 C.F.R. Part 230, App. A, ¶ A.2. For example, a grantee's costs must be "reasonable for the performance of the award[.]" *Id.*, ¶ A.2.a. "A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs." *Id.*, ¶ A.3.

In addition, a grantee's costs must be "allocable to" – that is assignable or chargeable to – its award or another "cost objective." *Id.*, ¶ A.2.a & A.4; *see also Fla. Farmworkers Council*, *Inc.,* DAB No. 202, at 5 (1981); *N.H. Dept. of Health & Human Servs.*, DAB No. 2399, at 6-7 (2011). The term "cost objective" is defined to include a grant, contract, project, service, or "other activity" of the grantee. 2 C.F.R. Part 230, App. A, ¶ 4.a. Costs must be allocated to a cost objective "in accordance with the relative benefits received" – that is, in some proportion that reflects the benefit conferred on the objective as a result of the costs having been incurred. *Id.*

Costs charged to a grant in violation of federal cost principles are subject to disallowance. *See* 45 C.F.R. § 74.62(a)(2) (Oct. 1, 2013); *Tex. Migrant Council, Inc.*, DAB No. 842 (1987) (sustaining a disallowance based on a violation of the federal cost principles); *Greater Philadelphia Health Action, Inc.*, DAB No. 1605 (1996) (upholding a disallowance of costs that the Board determined were not "reasonable" under the cost principles).

II. <u>Case Background</u>

In operating its Head Start and Migrant and Seasonal Head Start programs, TMC pays insurance premiums and incurs other costs intended to protect itself from financial loss. ACF Ex. 1, at 1. TMC pools these costs in a "Risk Management Fund" (also referred

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[2] The uniform administrative regulations in 45 C.F.R. Part 74 – which apply to non-profit organizations that receive grants or other awards administered by the Department of Health & Human Services, and which state that a grantee's allowable costs will be "determined in accordance with the cost principles applicable to the organization incurring the costs" (*id.* § 74.27(a)) – were in effect during the relevant period but recently superceded by regulations to be codified in 45 C.F.R. Part 75. *See* 79 Fed. Reg. 75,871, 75,899-75,900 (Dec. 19, 2014).

[3] This definition is from cost accounting standards published by OMB for federal procurement contracts. *Cost Accounting Standards Board; Statement of Objectives, Policies and Concepts*, 57 Fed. Reg. 31,036, 31,037 (July 13, 1992).

also as Fund A-085). ACF Ex. 7, ¶ 7. During the relevant time period, most of the costs accounted for in TMC's Risk Management Fund were worker's compensation insurance premiums and employee salaries. *Id.,* ¶¶ 8-9.

TMC allocates costs accumulated in the Risk Management Fund by applying a worker's compensation (or risk management) charge to its federal grants (and, apparently, to other organizational cost objectives). *See* ACF Ex. 7, ¶ 9. The amount charged is based on TMC's worker's compensation premium rates ("experience rates"), as modified by some "factor" necessary to reflect "additional, non-workmen's compensation expenses" accumulated in the Risk Management Fund. *Id.* The risk management charges applied to TMC's grants (and other cost objectives) are recorded as "revenue" to the Risk Management Fund. *Id.*, ¶¶ 10-12; ACF Ex. 1, at 1 (indicating that the fund's costs "are balanced by offsetting charges to revenue recorded in the Risk Management Fund").

In 2013, an accounting firm, Rubino & Company (Rubino), audited the Risk Management Fund in order to "verify the allowability and allocability of the costs accumulated within [that] pool and to confirm proper application of those costs to [TMC's] Head Start awards." ACF Ex. 1, at 1. Rubino analyzed the Risk Management Fund on a "policy year" basis. ACF Ex. 7, ¶ 8. The term "policy year" refers to the main worker's compensation policy maintained by TMC, which begins July 24 and ends on July 23 of the following year.[4] *Id.* Rubino's audit covered the four policy years between July 24, 2009 and July 23, 2013. *Id.*, ¶ 10. Rubino summarized its findings in a January 4, 2014 memorandum, which we refer to as the "Audit Report." ACF Ex. 1. An elaboration of the Audit Report's findings is contained in the affidavit of Rubino employee Patrick Curtis. ACF Ex. 7.

Based on conversations with TMC employees, including the accountant for the Risk Management Fund, Rubino found that the fund was supposed to operate on a "break even" basis during each policy year. ACF Ex. 7, ¶ 9. In other words, for each policy year, the fund's balance of expenses versus revenue was supposed to be zero. Rubino found that this outcome was necessary to ensure that the fund's costs were "appropriately allocated to" TMC's "final cost objectives" (including its federal grants). ACF Ex. 1, at 4.

To some extent, the risk management charges applied to TMC's grants (and to other cost objectives) reflected estimates of employee salaries accounted for in the Risk Management Fund and other fund costs that were subject to possible retrospective adjustment. *See* ACF Ex. 1, at 1 (noting that the cost estimates used were intended to cover "salaries and other direct costs associated with running the Risk Management

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[4] According to Rubino, TMC had two worker's compensation policies during the period examined: one for its Ohio employees, and a second policy (its main policy) covering its other employees. ACF Ex. 7, ¶ 8.

Fund"); ACF Ex. 7, ¶ 8 (stating that TMC's main worker's compensation policy was "subject to final audit by the insurance policy at which point expenses are trued up and any over/under payments are funded/invoiced to TMC"); ACF Ex. 1, at 4 (indicating that "[f]inal [insurance] policy audits [were] done following the completion of a policy year," resulting in "either credits received or payments required"). Despite that circumstance, Rubino found that TMC "ha[d] not reconciled actual costs incurred in the Risk Management Fund to its estimated costs for any of the policy years reviewed." ACF Ex. 1, at 1.

To compensate for that deficiency, ensure proper matching of the Risk Management Fund's expenses and revenue for each policy year, and determine the fund's year-end financial positions, Rubino made several "accrual based adjustments" to the fund's cost accounting. *See* ACF Ex. 7, ¶ 11 & ns. 2-6. Upon making those adjustments, Rubino discovered that the Risk Management Fund "operated at either a profit or loss in all of the years analyzed" and that TMC's grants and other cost objectives were either "overcharged" (in years when the fund showed a positive balance) or "undercharged" (in years when the fund showed a negative balance) for worker's compensation insurance and related risk management costs. *Id.*, ¶ 10. Rubino determined that the Risk Management Fund's cumulative net overcharge (or "profit") across the four-year period was $230,720, and that TMC's Head Start and Migrant Head Start programs absorbed $146,472 of that overcharge. *Id.*, ¶ 12 (table 3); ACF Ex. 1, at 5 (column of table titled "Effect of Adjustments to Pool").

In addition to calculating the Risk Management Fund's policy-year-end balances, Rubino examined whether certain costs had been appropriately pooled in the fund. ACF Ex. 1, at 2-4. Rubino identified two groups of questionable costs. The first consisted of monthly payments by TMC to a consultant named Romeo Sifuentes. ACF Ex. 7, ¶ 13. Upon examining the consultant's contract and invoices, Rubino determined that TMC's payments to him were "not allocable to" the Risk Management Fund because his work was unrelated to risk management. *Id.*, ¶¶ 13-14. Rubino commented, however, that the payments "benefitted" TMC's Migrant and Seasonal Head Start program and "should have been allocated to" to that program "in accordance with the relative benefits received." *Id.*, ¶ 14.

TMC's payments to Sifuentes totaled $167,208, and Rubino calculated that $159,151 of those costs had been allocated to TMC's federal grants as part of the worker's compensation charges applied to those cost objectives. *See* ACF Ex. 7, ¶¶ 22-24 (discussing the method used to estimate the "impact" on TMC's federal awards of costs determined to have been improperly assigned to the Risk Management Fund); ACF Ex. 1, at 5 (column of table titled "Removal of Romeo Sifuentes").

The second group of questionable costs consisted of salaries paid to five TMC employees. Based on a review of the employees' organizational functions, Rubino found that the salaries, totaling $607,941, had been improperly pooled in the Risk Management Fund because the employees did not perform, or were not primarily engaged in performing, risk management work. ACF Ex. 7, ¶¶ 16, 18; ACF Ex. 1, at 2-3. In addition, Rubino found that a portion of the questioned salaries had been simultaneously included in the pool of costs used to establish TMC's indirect cost rate. ACF Ex. 7, ¶ 18 (items 2 & 3); ACF Ex. 1, at 2-3. Rubino calculated that $505,949 of the $607,941 in salaries improperly pooled in the Risk Management Fund during the four policy years examined had been allocated from the fund to TMC's Head Start and Migrant and Seasonal Head Start grants. ACF Ex. 7, ¶¶ 19-20 (& Table 7), 22-24; ACF Ex. 1, at 5 (column of table titled "Effects of Payroll Adjustments").

Based on these findings, Rubino concluded that TMC had "over-applied" $811,572 in costs from its Risk Management Fund to the ten Head Start grants and four Migrant and Seasonal Head Start grants listed on page five of the Audit Report. ACF Ex. 1, at 5. That figure is equal to the sum of:

> **$146,472** (the amount of the risk management overcharge calculated by Rubino for policy years 2010-2013), *plus*
>
> **$159,151** (relating to TMC's payments to the consultant Romeo Sifuentes), *plus*
>
> **$505,949** (representing miscellaneous salaries that Rubino found to be unrelated to risk management)

Id. Rubino suggested that some of the so-called over-applied costs "could . . . be allocable to TMC's Head Start Awards" using different methods, such as "direct charges" or "allocation from [TMC's] indirect cost pool subject to any contractual or regulatory limitations." *Id.*

Concurring with Rubino's findings, ACF disallowed TMC's use of $811,572 in federal funds received under its various Head Start and Migrant and Seasonal Head Start grants. ACF Ex. 6. In support of that action, ACF's April 2014 notice of disallowance notice cited the cost principles in OMB Circular A-122 regarding allocable costs (2 C.F.R. Part 230, App. A, ¶ A.4) and stated that $811,572 in costs "were not properly allocated to TMC's Risk Management Fund in violation of" those principles. *Id.* at 5.

TMC then filed this appeal. The Board stayed the appeal for a short period to allow the parties to conduct discovery. During that period, TMC asked for and received relevant documents from ACF, including Rubino's audit report and audit workpapers. After ACF filed its response brief, TMC asked ACF to produce additional material cited in the Curtis affidavit but not provided during the discovery period. ACF produced that additional

material on February 11, 2015. TMC filed its reply brief 41 days later, on March 24, 2015.

III. Discussion

"In an appeal of a federal agency's disallowance determination, the federal agency has the initial burden to provide sufficient detail about the basis for its determination to enable the grantee to respond." *Me. Dept. of Health & Human Servs.*, DAB No. 2292, at 9 (2009), *aff'd*, *Me. Dept. of Human Servs. v. U.S. Dept. of Health & Human Servs.*, 76 F. Supp. 2d 288 (D. Me. 2011). If the agency carries this burden, which the Board has called "minimal," then the non-federal party (the grantee, in this case) must demonstrate that the costs are, in fact, allowable. *Mass. Executive Office of Health & Human Servs.*, DAB No. 2218, at 11 (2008), *aff'd*, *Commonwealth of Mass. v. Sebelius*, 701 F. Supp. 2d 182 (D. Mass. 2010). "When a disallowance is supported by audit findings, the grantee typically has the burden of showing that those findings are legally or factually unjustified." *Id.*

As the background indicates, the disallowance relates to three groups of costs – totaling $811,572 – that were allocated to TMC's various federal grants from the Risk Management Fund. We consider each group separately.

A. *ACF properly disallowed the overcharge of $146,472 for risk management.*

Based on its analysis of the Risk Management Fund's accounting, Rubino found – and TMC does not dispute – that its Head Start awards were "overcharged" $146,472 for risk management during policy years 2010 through 2013. In other words, Rubino found that the risk management charges applied to TMC's awards (and recorded as fund revenue) exceeded the costs (recorded as fund expenses) that TMC actually incurred for risk management. (As indicated, the available evidence indicates that TMC's risk management activity consisted largely of acquiring worker's compensation coverage for its employees.)

ACF submits that the overcharge violated the general principle in OMB Circular A-122 that costs be "reasonable."[5] Response Br. at 15-16. A number of circumstances support that view. First, the overcharge reflects a failure by TMC to comply with its own cost

[5] ACF did not cite the reasonableness cost principle in its April 2014 notice of disallowance. *See* ACF Ex. 6. That omission did not preclude ACF from relying on that principle in this appeal, for the Board permits a federal agency to revise or supplement its rationale for a disallowance during the course of an appeal unless the non-federal party has been deprived of an adequate opportunity to respond to the agency's change in position. *Mass. Executive Office of Health & Human Servs.* at 10 n.9. Here, ACF raised the reasonableness issue in its Response Brief. Thus, TMC had an opportunity to respond to that issue in its Reply Brief, which it did not do. TMC does not allege that it lacked an adequate opportunity to respond to any argument presented in ACF's brief.

accounting policy, which called for the Risk Management Fund to break even on a policy year basis. Second, TMC failed to perform procedures – most notably, annual reconciliations of estimated and actual costs – to ensure compliance with that policy. Third, Rubino identified no obstacles preventing TMC from identifying actual risk management costs and performing timely reconciliations. Finally, there is no evidence that charging for risk management in excess of actual costs was necessary for the performance of TMC's grant-supported programs.

These circumstances were sufficient to question TMC's compliance with the reasonableness cost principle and shift the burden to TMC to demonstrate that the overcharge was, in fact, a reasonable cost under OMB Circular A-122. *See* 2 C.F.R. Part 230, App. A, ¶ A.3 (specifying factors relevant to a determination of a cost's reasonableness, including whether a cost is "of a type generally recognized as *ordinary and necessary* for the operation of the organization or the performance of the award" and whether the cost reflects "[s]ignificant *deviations from the established practices* of the organization which may unjustifiably increase the award costs" (italics added)); 45 C.F.R. § 74.81 (Oct. 1, 2013) ("no HHS funds may be paid as profit to any recipient even if the recipient is a commercial organization"); Dept. of Health & Human Servs., Grants Policy Directive 3.01B ("No HHS grant, other than an award under the Small Business Innovation Research . . . or the Small Business Technology Transfer . . . program, will include any *increment above cost*, whether termed 'profit' or 'fee'" (italics added)); *East Mo. Action Agency, Inc.*, DAB No. 1802 (2001) (holding that it was "simply unreasonable" to charge a Head Start program for unemployment taxes not "actually incurred").[6] TMC did not carry that burden. In fact, TMC made no attempt to demonstrate, with evidence or argument, its compliance with the reasonableness cost principle. *See* Reply Br. at 4-7.

TMC asserts that "ACF has not explained how it arrived at the decision to disallow" $146,472. Reply Br. at 5. We disagree. That decision was based on findings laid out in the Audit Report and Curtis affidavit. Those documents explain in detail how Rubino calculated the overcharge (that is, the Risk Management Fund's cumulative "profit") and the portion of that overcharge absorbed by TMC's federal Head Start and Migrant and Seasonal Head Start grants. *See* ACF Ex. 1, at 4; ACF Ex. 7, ¶¶ 10-12, 22-24. TMC does not specify gaps or other deficiencies in ACF's materials that prevented an adequate response.

In its appeal brief, ACF states that the disallowed overcharge totaled $230,720 – not $146,472 (the figure cited in the disallowance letter). Response Br. at 10. TMC suggests that ACF's use of the higher figure means that it has unjustifiably "attempted to increase

[6] HHS Grants Policy Directives are available at http://www.hhs.gov/asfr/ogapa/aboutog/ogpoe/gpdhome.html (last visited May 12, 2015).

[this portion of] the disallowance by more than half." *Id.* at 4-5. We do not agree. ACF simply cited the wrong figure. It is reasonably clear from the Audit Report and Curtis affidavit that the higher figure ($230,720) represents the total overcharge to *all* of TMC's programs or functions, some of which were (presumably) unrelated to its Head Start and Migrant and Seasonal Head Start programs. The lower figure – $146,742 – represents the portion of the overcharge absorbed by the ten Head Start and four Migrant and Seasonal Head Start grants listed on page five of ACF's disallowance letter (ACF Exhibit 6).

TMC makes other assertions that we need not address because they are unresponsive to Rubino's audit findings and fail to address the applicable federal cost principles. We therefore hold that TMC's Head Start and Migrant and Seasonal Head Start grants were charged $146,472 in violation of the principle in OMB Circular A-122 that federal awards be charged only for reasonable costs.[7]

B. *Costs relating to Romeo Sifuentes were properly disallowed because TMC failed to demonstrate that they had been allocated to its federal grants "in accordance with the relative benefits received" by those awards.*

We next consider the portion of the disallowance concerning the payments to Romeo Sifuentes. Those payments were accumulated in the Risk Management Fund and reflected in the risk management charges applied to TMC's various grants and other organizational cost objectives. *See* ACF Ex. 7, ¶ 9. TMC does not dispute Rubino's finding that Sifuentes's services were unrelated to risk management and should not have been pooled in the Risk Management Fund.

In its appeal brief, ACF asserts that the payments to Sifuentes did not "benefit[ ] [TMC's] risk management activities" and that TMC "failed to provide any documentation showing a basis for allocating the consulting costs to risk management activities." Response Br. at 7-8. Consequently, says ACF, the payments were not "allocable as charged to Head Start grant awards." *Id.* at 7. Repeating language from its disallowance notice, ACF also asserts that the Sifuentes payments were "not allocable to the Risk Management Fund." *Id.*

TMC responds that disallowance of these costs (and of the costs discussed in the following section) rests on an "incorrect understanding" of the allocability principle. TMC Br. at 4. TMC asserts that the "concept of allocability applies in determining whether a particular expenditure *benefits activities under an award*, not whether an awardee properly characterized the expenditure in its book of accounts." TMC Br. at 5 (italics added). In TMC's view, the relevant inquiry is not whether the costs in

[7] ACF offered other reasons to justify the disallowance of the overcharge. Response Br. at 10-14. We do not consider them because TMC's violation of the reasonableness cost principle was sufficient justification.

question "are attributable to . . . risk management activities," or were properly pooled in the Risk Management Fund, but whether the costs actually "benefited" its Head Start and Migrant and Seasonal Head Start programs. *Id.* at 5-6. TMC asserts that ACF did not allege a lack of program benefit and points to evidence (the Curtis affidavit) showing just the opposite. *Id.*

We agree that ACF's focus is misplaced. In the context of a disallowance, the allocability principle ordinarily entails an inquiry into the relationship between a grantee's costs and a "final cost objective," a term that includes a federal award itself or any program, project, or other "direct activity" of the organization.[8] *See* 2 C.F.R. Part 230, App. A, ¶ B.1. In this case, the relevant final cost objectives were TMC's Head Start and Migrant and Seasonal Head Start grants, not the Risk Management Fund. The allowability of the Sifuentes payments depends ultimately on whether, or to what extent, they were fairly or equitably assigned to those objectives. *Minn. Dept. of Pub. Welfare*, DAB No. 466 (1983) (noting the "critical" question of whether a grantee's use of a cost pool "result[ed] in a fair distribution of charges to the various programs").

That does not mean TMC's use of the Risk Management Fund to account for the Sifuentes payments is irrelevant. The purpose of a cost pool, like the Risk Management Fund, is to accumulate costs that are not specifically identified with an organization's programs or other final cost objectives for the purpose of allocating them to those objectives.[9] *Minn. Dept. of Pub. Welfare*. Costs in the pool are assigned to cost objectives using a single, appropriate "distribution base." *Id.* The distribution base is a cause-and-effect or other logical factor which produces a reasonable measure of the relative benefits conferred by those costs on the organization's major programs and activities. *See* 2 C.F.R. Part 230, App. A, ¶ D.3.c (stating that "[t]he essential consideration in selecting a method or a base is that it is the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic

[8] OMB Circular A-122 defines "allowable" costs with reference to their relationship with final cost objectives. The "total cost of a [federal] award is the sum of the *allowable direct and allocable indirect costs* less any applicable credits." 2 C.F.R. Part 230, App. A, ¶ A.1 (italics added). "*Direct costs* are those that can be identified specifically with a particular final cost objective[.]" *Id.*, ¶ B.1 (italics added). "*Indirect costs* are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective" and thus must be assigned to final cost objectives on some equitable basis. *Id.*, ¶¶ C.1, D (italics added).

[9] The recently published uniform administrative requirements, costs principles, and audit requirements differentiate between "final" and "intermediate" cost objectives, defining the latter as a "cost objective that is used to accumulate indirect costs or service center costs that are subsequently allocated to one or more indirect cost pools or final cost objectives." 2 C.F.R. § 200.60; *see also Minn. Dept. of Pub. Welfare* (stating that a "cost objective can be the grant program that will ultimately be charged the costs, or it can be a center that accumulates costs under some general category for future distribution to the programs to be charged").

and reason, where neither the cause nor the effect of the relationship is determinable"); *D.C. Dept. of Human Servs.*, DAB No. 1005 (1988) (noting that a portion of pooled costs is charged to each benefitting program "with the intent that the method of allocation will distribute the costs . . . in amounts that as accurately as possible reflect the relative benefit received by each program," with the accuracy of the distribution depending "on whether the allocation method is sound and is properly used"). Put more concisely, the distribution base is a way of estimating the extent to which an organization's programs or activities (*i.e.*, the cost objectives) use or consume shared resources.

OMB Circular A-122 indicates that when a cost pool is used to allocate costs of a defined function (such as risk management), the costs placed in the pool should be of "*like character* in terms of functions [cost objectives] they benefit and in terms of the allocation base which best measures the relative benefits provided to each function." 2 C.F.R. Part 230, App. A, ¶¶ D.3.b (discussing "cost groupings" that are appropriate under a "multiple allocation base method, which should be used when the organization's indirect costs "benefit its major functions in varying degrees"). This means that the pooled costs should be similar enough – in terms of their characteristics and relationship to the relevant cost objectives – to ensure that the distribution base used to allocate them results in each objective bearing its fair share of the costs (that is, in accordance with the relative benefits received). For example, utilities, property taxes, and maintenance costs associated with owning and operating a building could be grouped in a single cost pool for allocation to the organizational departments (cost objectives) housed in that building. This grouping is appropriate because the pooled costs benefit each of the organization's departments and because there is a single factor – namely, square footage occupied by each department – that provides a fair measure of the beneficial relationship between each type of cost and each cost object.

In view of these principles, we reject TMC's suggestion that accounting for the Sifuentes payments in the Risk Management Fund did not create an allocability problem. The fund's costs were distributed to TMC's final cost objectives based on a modified worker's compensation premium rate. *See* ACF Ex. 7, ¶ 9. This methodology likely resulted in an equitable allocation of the fund's *true* risk management costs, such as worker's compensation premium payments and salaries of employees who perform risk management-related functions. *Cf.* 2 C.F.R. Part 230, App. B, ¶ 8.g.2 (indicating that costs of worker's compensation and other fringe benefits, "whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner *consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards* and other activities" (italics added)). However, there is no reason to think the same methodology was appropriate to allocate costs – such as the Sifuentes payments (and salaries discussed in the next section) – that were unrelated to risk management. In other words, it is highly

doubtful that the Sifuentes payments were, as OMB Circular A-122 requires, similar to the risk management costs in the cost pool "in terms of the allocation base which best measures the relative benefits provided to each function." Moreover, unlike TMC's risk management activity, Sifuentes's work did not benefit all of TMC's final cost objectives, only its Migrant and Seasonal Head Start (MSHS) grants. TMC Ex. 4, at 2 (showing that Sifuentes was contracted to work only on TMC's MSHS grants). Even so, some portion (albeit a small one) of Sifuentes's compensation was allocated from the Risk Management Fund to TMC's Head Start grants. *See* ACF Ex. 4; Ex. 1, at 5. These circumstances persuade us that the Sifuentes payments were probably not allocated to TMC's awards "in accordance with the relative benefits received," contrary to federal cost principles.

TMC urges the Board to reverse the disallowance of these costs because ACF has never contended that they "did not benefit the MSHS program . . . in the proportion they were charged to" the MSHS grants. TMC Br. at 5. Although ACF's appeal brief does not precisely spell out the nature of the allocability problem posed by the improper pooling of the Sifuentes costs, reversal is not warranted.

According to the Audit Report, Rubino's task was to "confirm proper application" of Risk Management Fund costs to TMC's Head Start and Migrant and Seasonal Head Start grants. ACF Ex. 1, at 1. After determining that the Sifuentes payments were not related to risk management, Rubino backed those costs out of the fund, effectively reversing their allocation to TMC's awards. *See* ACF Ex. 7, ¶¶ 20, 22-24. Rubino also noted that those costs (and the salaries discussed in the next section) might be allocable to the awards using *different methods*, such as "direct charges" or "allocation from [TMC's] indirect cost pool." ACF Ex. 1, at 5.

These audit findings, which ACF adopted in full, adequately notified TMC that ACF was questioning the appropriateness of using the Risk Management Fund to allocate the Sifuentes payments. TMC therefore had the burden to show that its awards were equitably charged for those costs (either because of, or in spite of, the allocation methodology used). *W. Va. Dept. of Health & Human Resources*, DAB No. 2529, at 3 (2013) (stating that, "[i]n general, the burden is on the entity challenging a disallowance to demonstrate that the disallowed costs are, in fact, allocable to the program in question"); *N.Y. State Dept. of Social Servs.*, DAB No. 1063 (1989) (finding that the non-federal party bore the burden "to establish that . . . costs were equitably distributed in the context of the overall cost pool" when the federal agency produced "evidence that call[ed] for further inquiry"). TMC made no attempt to do so in this proceeding. We therefore conclude that the $159,151 in costs relating to Romeo Sifuentes were properly disallowed.

C. *ACF properly disallowed $505,949 in salaries allocated to TMC's awards through the Risk Management Fund.*

The analysis in the previous section applies equally to the salaries that Rubino found (and that TMC does not dispute) were improperly assigned to the Risk Management Fund but nonetheless allocated from that cost pool to TMC's awards. The salaries reflected employee activity unrelated to risk management, making it highly improbable that the chosen distribution base (modified insurance premium rates) appropriately measured their benefit to each final cost objective. TMC offered no evidence that its allocation of the non-risk-management-related salaries was "in accordance with the relative benefits received," as OMB Circular A-122 requires. We therefore sustain the portion of the disallowance – $505,949 – relating to those costs.

We mention one additional issue concerning the salaries. Rubino found, and ACF concurred, that some unspecified portion of those costs was simultaneously included in TMC's general indirect cost pool and allocated through that pool to TMC's grants. ACF Ex. 1, at 4; ACF Ex. 6, at 4. The result, it appears, is that TMC's grants were double-charged for certain costs. The amount of the duplication is unclear, but quantification is unnecessary because we conclude that *all* of the salaries improperly allocated through the Risk Management Fund were subject to disallowance for the reasons stated in the previous paragraph.

D. *This decision does not preclude TMC from proposing a reallocation of certain costs and requesting that ACF review the disallowance based on that reallocation.*

In light of evidence that the Sifuentes payments (discussed in section II.B) and miscellaneous salaries (discussed in section III.C) are *potentially* allocable to TMC's awards by methods other than distribution through the Risk Management Fund, this decision shall not preclude TMC from proposing to ACF a reallocation of those costs. TMC should submit any proposed reallocation to ACF within 45 days of the date of this decision (or within any longer period that ACF may allow). ACF may then determine whether, or to what extent, the proposed reallocation meets relevant federal requirements and complies with TMC's negotiated indirect cost rate agreements. If necessary, ACF should consult with HHS's Office of Cost Allocation Services to help resolve any cost allocation or indirect cost rate issues posed by TMC's reallocation proposal. If ACF determines that TMC has proposed an acceptable reallocation, and that the reallocated costs are otherwise compliant with the terms and conditions of TMC's awards, then ACF may reduce the disallowance accordingly.

Conclusion

We sustain ACF's April 2014 disallowance of $811,572 subject to any reduction that ACF may make if TMC proposes an acceptable reallocation of the costs discussed in sections III.B and III.C of this decision.

/s/

Leslie A. Sussan

/s/

Susan S. Yim

/s/

Stephen M. Godek
Presiding Board Member