

Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Texas Neighborhood Services, Inc.
Docket No. A-14-76
Ruling No. 2014-4
July 8, 2014

RULING ON REQUEST FOR RECONSIDERATION

Texas Neighborhood Services, Inc. (TNS) asks the Board to reconsider its May 9, 2014 decision, *Texas Neighborhood Services, Inc.*, DAB No. 2571 (2014). In that decision, the Board upheld a determination by the Administration for Children and Families (ACF) disallowing a total of \$1,392,261.09 in federal funding provided to TNS for its Head Start and Early Head Start programs for TNS's fiscal years ending April 30, 2010 through 2012 (FYs 2010, 2011, and 2012). The Board concluded that ACF properly disallowed \$1,332,608.09 in incentive compensation payments that TNS made to its employees for FYs 2010-2012 but failed to establish were reasonable, supported by adequate documentation, and made pursuant to a pre-existing agreement or established plan. The Board also concluded that ACF properly disallowed floor repair costs totaling \$59,653 that TNS charged to its Head Start/Early Head Start award for FY 2012 but did not obligate until FY 2013.

The Board has the authority to reconsider its own decision where a party "promptly alleges a clear error of fact or law." 45 C.F.R. § 16.13. TNS alleges that the Board made three such errors in upholding the disallowance related to incentive compensation payments. First, TNS contends that the Board upheld the disallowance on grounds different from those raised in ACF's disallowance letter and so deprived TNS of the opportunity to adequately defend against the disallowance. Second, TNS argues that the Board held TNS to an evidentiary standard inconsistent with the applicable cost principles and the Board's prior precedent. Finally, TNS argues that the Board erroneously upheld the disallowance in its entirety rather than disallowing only those payments that were clearly improper and remanding the remainder to allow TNS to submit supportive documentation to ACF. As explained below, we conclude that TNS's arguments lack merit and thus that its request does not allege any clear error of fact or law. We therefore deny the request.

Discussion

1. The Board upheld the disallowance on the same grounds relied on by ACF, so TNS had adequate notice and an opportunity to respond.

TNS asserts that the Board violated “settled principles of administrative law” by upholding the disallowed incentive compensation payments on grounds different from those articulated by ACF in its disallowance letter and monitoring report, and thus deprived TNS of adequate notice of the basis of the disallowance and the opportunity to respond and to show that the basis was inappropriate. Mot. for Recon. at 1-2, 5-6. TNS argues that ACF never determined that employee-specific documentation was necessary to substantiate the incentive awards, but the Board nonetheless upheld the disallowance on the ground that TNS “failed to provide individual employee-by-employee documentation for every incentive award given.” *Id.* at 4.

As an initial matter, the Board did not uphold the disallowance simply because TNS failed to provide documentation substantiating each individual award. As noted above, the Board concluded that TNS failed to establish that its awards were reasonable, supported by adequate documentation, and made pursuant to a pre-existing agreement or established plan. Decision at 3-11.

In concluding that TNS did not adequately document the basis for its awards, the Board noted that TNS had not produced the employee-specific documentation that its incentive compensation policies required it to use when determining whether to give an award and that the documentation TNS did produce showed that it failed to follow its incentive compensation policies when giving out the awards. Decision at 5-8. The Board’s observations and conclusion are fully consistent with the position taken by ACF in its monitoring report and disallowance letter and on appeal to the Board. *See* TNS Ex. A at 9-10 (monitoring report) (finding that TNS was “unable to document the basis for amounts awarded” and noting that TNS’s Chief Financial Officer was able to provide only an “undated Scoring Matrix for Incentives and stated the plans of performance were missing and unable to be located”); *id.* at 1 (disallowance letter) (explaining that awards were disallowed “as being unreasonable and unallowable due to lack of support” and noting that “there was no support to indicate which employee met the requirements of which band of [performance] criteria”); ACF Resp. Br. at 11-12 (arguing that TNS’s documentation showed it “clearly failed to follow the directives of its” incentive compensation plan and did not contain any “individual performance evaluations indicating the employees’ contribution to the program,” nor any “documentation indicating the basis for and calculation of how much would be paid for employees in each of the levels based on the availability of funds”). Indeed, in its decision the Board quoted

from the monitoring report and reasoned that, based on the report, “TNS was on notice as early as April 2013, when the monitoring report was issued, that it needed to provide employee-specific documentation to justify its incentive compensation awards.” Decision at 7 n.4. TNS does not identify any error in this Board finding.

TNS further argues that its incentive compensation policy does not require it to create and maintain “individual documentation as part of the compensation process,” and thus that the Board’s decision “demonstrated a fundamental misunderstanding” of the policy. Mot. for Recon at 1, 5. TNS misrepresents its own policies, which specifically require the creation and maintenance of employee-specific documentation related to incentive compensation awards. As the Board noted in its decision, TNS’s Compensation Plan contains a matrix for “determining employee worth to the organization” that TNS “will follow” in determining incentive compensation awards. Decision at 4. That matrix provides that employees’ ratings will be based in part on individual “Personnel Performance Appraisals.” *See id.* at 6; TNS Ex. D at 4-5. The Compensation Plan also provides that “[m]emorandums describing the [incentive compensation] payments will be generated each year to the employee and their files to document compliance” with the Plan. TNS Ex. D at 2. Thus, contrary to what TNS argues, there was no error in the Board’s finding regarding the type of documentation that TNS should have been able to produce to justify its awards.

Moreover, to the extent TNS contends that the payroll documentation it submitted on appeal was adequate to substantiate the awards, the Board’s decision explained in detail why that documentation was inadequate (Decision at 5-8), and TNS does not identify any error in the Board’s reasoning.

2. The Board’s conclusions regarding TNS’s failures were consistent with the cost principles and prior Board decisions.

TNS contends that by requiring it to produce “employee-specific documentation” to substantiate the basis for its incentive compensation awards, the Board imposed a higher evidentiary standard than is contemplated in the applicable cost principles and the Board’s prior decisions. Mot. for Recon. at 6. TNS argues that under paragraph 8(j) of the applicable cost principles, it was required to show only that its incentive compensation payments were “based on cost reduction, or efficient performance” and made “pursuant to an established plan followed by the organization.” *Id.*, quoting 2 C.F.R. Part 230 (2010-2013), App. B ¶ 8.j. TNS also cites to two Board decisions, *Seaford Community Action Agency*, DAB No. 1433 (1993), and *Washington County Opportunities, Inc.*, DAB No. 1464 (1994), in which, it argues, the Board did not impose “such onerous documentation requirements.” *Id.* at 7.

The Board's analysis is consistent with the cost principles. By focusing only on the requirements for incentive compensation set forth in paragraph 8(j), TNS ignores the overarching, general requirements in the cost principles that all costs be reasonable and adequately documented. *See* 2 C.F.R. Part 230, App. A ¶ A.2.a, g. In any event, the Board also found that TNS's incentive compensation awards were inconsistent with paragraph 8(j) because they were not paid pursuant to an established plan that TNS "consistently" followed, as that section requires. *See, e.g.*, Decision at 8 (noting that the documentation TNS submitted "shows it failed to follow its compensation policies in many respects"). TNS points to no specific error in the Board's analysis.

The Board's analysis is also consistent with *Seaford* and *Washington County*. In *Seaford*, ACF disallowed one-time supplemental salary payments made to Head Start employees on the ground that the grantee had no established policy or practice of making such payments. DAB No. 1433, at 5-6. The Board reversed the disallowance in part, concluding that the grantee had both a written policy providing for supplemental payments and a long-standing practice of awarding such payments to eligible employees, and that the payments were largely consistent with the grantee's policy and practice. TNS argues that in *Seaford* the Board accepted certain evidence of the grantee's established practices – "payroll registers, minutes of Policy Council meetings, evaluation sheets, and lists of awardees" – that parallels the evidence TNS provided here. Mot. for Recon. at 7, quoting *id.* at 6. However, the Board's acceptance of such evidence in *Seaford* is irrelevant, because here the basis for the disallowance was not TNS's failure to have an established policy but rather its failure to show that it made payments in accordance with the policy.

In *Washington County*, ACF disallowed one-time bonus payments made to all of the grantee's staff on the ground that the payments were not based on incentive or individual performance or paid in accordance with a prior good-faith agreement. DAB No. 1464, at 5-6. The Board reversed the disallowance (without prejudice to ACF's further consideration of whether the bonus amounts were reasonable), concluding that the grantee's interpretation of its bonus policy established that all bonuses were incentive-based, that minutes from management meetings established that the grantee decided to award bonuses because it believed the entire staff's performance merited a reward, and that the grantee "clearly applied its policy" in authorizing the payments. *Id.* at 6-7. TNS emphasizes that in *Washington County* the Board "admitted that '[t]he cost principles do not require formula-based bonuses'" (Mot. for Recon. at 7, quoting *id.* at 7), but the Board did not reach a contrary conclusion here. In *Washington County*, the Board noted that it was not significant that the grantee's policy did not provide a formula for determining bonus eligibility and amount because the cost principles do not require such

formulas and because the grantee paid every employee the same bonus amount. DAB No. 1464, at 7. Here, in contrast, TNS's policies set forth a formula for determining entitlement to incentive compensation on an individual basis, but the documentation TNS produced showed that it did not consistently follow its formula in making incentive compensation awards.

TNS also argues that the Board erroneously treated ACF's finding that TNS's incentive compensation payments were unreasonable as unrebuttable, contrary to prior Board precedent. Mot. for Recon. at 8-10. However, rather than concluding that ACF's finding of unreasonableness was unrebuttable, the Board concluded that TNS failed to rebut ACF's finding and show that its payments were reasonable. Decision at 9-11. TNS attacks the Board's conclusion, but identifies no clear error of fact or law in the Board's reasoning.

According to TNS, ACF made only "conclusory" and "tautological statements of unreasonableness," which TNS sufficiently rebutted by producing a wage comparability study that TNS alleges shows its incentive compensation payments were "within the established salary range for similar positions." Mot. for Recon. at 8-9. However, ACF relied on the undisputed facts regarding the amounts of incentive awards made, in total and individually, and what percentage of the awardees' salaries those amounts represented. Decision at 9. TNS contends that a "finding of unreasonableness necessarily involves a comparison, so that the amount in question can be *contrasted* with usual practices," and argues that ACF did not rely on any comparisons to determine that TNS's awards deviated from usual practices. Mot. for Recon. at 9 (emphasis in original). Significant deviation from usual practices is only one factor to consider in determining whether a cost is reasonable, however. As the Board pointed out in its decision, the cost principles also provide for consideration of other factors, including whether the cost exceeds the amount "which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs." Decision at 9, quoting 2 C.F.R. Part 230, App. A ¶ A.3. Some of the award amounts here on their face exceeded what a prudent person would think would be necessary to provide an incentive to the employees to remain with the organization and/or to perform well. In addition, TNS gave different awards, both in terms of actual money awarded and in terms of the award as a percentage of an employee's actual salary, to employees who received the same ratings; gave more generous awards to employees with lower ratings; and gave significantly higher awards to management employees than to non-management employees. As the Board noted, a prudent person would not determine incentive awards in what appears to be an arbitrary manner. *Id.* at 11.

The Board also pointed out in its decision several inadequacies with the wage comparison study TNS proffered. *See* Decision at 10. TNS now argues that it was never making the claim that the study is "necessarily determinative of a finding of reasonableness" but that "absent any further showing from ACF . . . its rebuttal of ACF's position was sufficient."

Mot. for Recon. at 8. TNS relies on *Adelphi University*, DAB No. 39 (1977), and *Central New York Health Systems Agency, Inc.*, DAB No. 239 (1981), where the Board concluded that the grantees had overcome the agency's findings of unreasonableness. *Id.* at 8-9.

Both of the cited cases are distinguishable. In *Adelphi*, the grantee produced favorable evidence that directly addressed the issue in that case – the reasonableness of its employee's salary increase. The evidence TNS proffered here through the wage comparison study did not address the relevant issue – whether the amounts of its incentive awards were reasonable – and instead addressed the overall compensation level of TNS's employees. *See* Decision at 10. TNS presented no evidence regarding the amounts of a comparable organization's incentive awards as a percentage of salary. Moreover, unlike the grantee in *Central New York*, TNS provided no evidence of special circumstances that might justify it paying a higher percentage award than typically paid in order to retain qualified, well-performing staff.¹

Thus, the Board's conclusions that TNS did not adequately document the basis for its incentive compensation awards and or show that the awards were reasonable were consistent with the cost principles and prior Board decisions and were not based on a novel evidentiary standard.²

3. The Board correctly upheld the entire disallowance of incentive compensation payments.

TNS further argues that even if the Board correctly found that “some of TNS's incentive compensation payments were not made pursuant to its established policies and thus were unallowable,” the Board should not have upheld the disallowance of all of TNS's payments for FYs 2010-2012. Mot. for Recon. at 10. Instead, TNS asserts, the Board should have either “remand[ed] the questionable payments to ACF or disallow[ed] only those payments that were clearly contrary to TNS's policies.” *Id.* at 11.

TNS mischaracterizes the Board's decision. As discussed above, in addition to concluding that TNS did not follow its incentive compensation policies in many respects in making the payments, the Board also found that none of the payments were adequately documented and that the payments were unreasonable. Therefore, this was not a case in which the Board concluded that some of the payments may have been allowable.

¹ We also note that the circumstances here required particular scrutiny because TNS received most of its funding from federal grants and because some of the highest incentive compensation awards went to the management officials who decided how to distribute the awards.

² Even if we had erred in finding that some of the awards were unreasonable, that error would not be a basis for reconsideration of our decision, since the decision was fully supported by other grounds.

TNS takes particular issue with the Board's rejection of the proffer it made in its reply brief to produce performance appraisal documentation for several employees upon request. Mot. for Recon. at 12. TNS argues that the Board should have remanded to ACF "those payments" where documentation was lacking "pending the submission of additional information by TNS." *Id.* The Board's decision not to remand for consideration of the 20 performance appraisals TNS offered to produce was reasonable because, as the Board explained in its decision, even with respect to the relatively few employees for whom TNS proffered such documentation, TNS did not proffer evidence to show that the employees met the other criteria in its matrix for making incentive awards. Accordingly, the performance appraisal documentation would not have been sufficient to substantiate TNS's awards. *See* Decision at 7-8.

Conclusion

For the reasons stated above, we conclude that TNS has not shown a clear error of fact or law in our decision in DAB No. 2571. Therefore, we decline to reconsider that decision.

_____/s/
Sheila Ann Hegy

_____/s/
Leslie A. Sussan

_____/s/
Judith A. Ballard
Presiding Board Member