

DAB Upholds Disallowance of Reimbursement Request

By Allison Ma'luf, Esq. and Allison McAndrew, CAPLAW

Strategic Community Services, Inc.
DAB No. 2333 (2010)¹

A recent decision of the U.S. Department of Health and Human Services (HHS) Departmental Appeals Board (DAB) affirmed the disallowance of approximately \$40,000 in compensation paid to a project director by a nonprofit receiving grant funds from the Substance Abuse and Mental Health Services Administration (SAMHSA). The DAB upheld the disallowance based on the project director being both an officer of the nonprofit and the brother of the nonprofit's president, in violation of federal conflict of interest requirements, the HHS Grants Policy Statement, and the nonprofit's conflict of interest policy. Additionally, the DAB found that the nonprofit's failure to obtain prior approval to hire the project director as a consultant, rather than as an employee, violated federal regulations and terms of the grant.

Background

Strategic Community Services, Inc. (SCSI) is a Maryland nonprofit operating a Drug Free Communities program in Florida under a five-year grant received from SAMHSA. The grant gave SCSI approval to hire a project director as a salaried employee. SCSI hired Jon Quinton, the brother of its president, for the position as a consultant rather than as an employee. An application to do

“SCSI failed to comply with federal conflict of interest requirements and its own conflict of interest policies.”

business in Florida, filed before SCSI hired Mr. Quinton, listed Mr. Quinton as secretary and listed Mr. Quinton's sister, Sylvia Quinton, as president and was signed by her as president. While Mr. Quinton acted as project director, annual corporate reports filed in Florida for six consecutive years listed him as secretary and his sister as president and were signed by him as secretary. SAMHSA informed SCSI of its intention to disallow costs based on SCSI hiring its secretary and its president's brother as the project director and as a consultant rather than as an employee. SCSI responded by filing a corporate

reinstatement form replacing Mr. Quinton and his sister as officers of SCSI.



The federal uniform administrative requirements for grants and subgrants to nonprofits are found in 2 C.F.R. Part 215 (OMB Circular A-110). Federal agencies including HHS have adopted similar versions in their regulations. HHS requires grantees to maintain written standards of conduct for procurement of goods and services that prohibit employees and officers from participating in the selection, award or administration of any federally funded contracts if a real or apparent conflict of interest exists.² The regulations explain that a conflict arises when an employee, officer, agent or any member of his or her family has a financial or other interest in a transaction supported by federal funds.

The HHS Grants Policy Statement specifically states that it applies to all discretionary grants (such as Head Start grants) but not to mandatory grants (including block grants such as the Community Service Block Grants (CSBG)).³ The policy statement requires grantees to include in their written standards of conduct “safeguards to prevent employees, consultants, members of governing bodies, and others who may be involved in grant-supported activities from using their positions for purposes that are, or give the appearance of being, motivated by a desire for private financial gain for themselves or others, such as those with whom they have family, business, or other ties.”⁴

SCSI Failed to Manage Conflicts of Interest

SAMHSA argued that SCSI's hiring of Mr. Quinton as project director violated the federal conflict of interest regulations because he was the brother of SCSI's then president and was an officer of SCSI. Moreover, SCSI failed to show that it hired Mr. Quinton in an arms-length manner. SCSI argued that Mr. Quinton was not an officer

(Continued on page 16)

Disallowance *(continued from page 6)*

of SCSi and “never participated in any of the SCSi board or corporate activities.” Mr. Quinton simply signed the Florida corporate forms and filed them without consulting a lawyer or SCSi. SCSi relied on a corporate form filed in Maryland and an IRS filing, neither of which named Mr. Quinton as an officer or a board member. SCSi also contended that SAMHSA knew of Mr. Quinton’s familial relationship with SCSi’s president. SCSi provided an email from Mr. Quinton to SAMHSA which explained that his sister “did not participate in the selection, award, or administration of the contract because [she was] not the authorized official on the grant ... not a member of the board of directors, and ... does not manage the affairs of the organization in Florida.”

The DAB found that SCSi failed to comply with federal conflict of interest requirements and its own conflict of interest policy when it hired an officer of SCSi and its president’s brother. The DAB first rejected SCSi’s arguments that Mr. Quinton was neither an officer nor a board member. The Maryland forms provided by SCSi were inconsistent with one another and with the Florida forms and both the Maryland and IRS forms were incomplete. The DAB explained that SCSi could have submitted other documents, such as testimonial evidence and board meeting minutes, to support its position that Mr. Quinton was not an officer and to show that, even if he were an officer, he and his sister recused themselves from the decision-making process.

Moreover, according to the DAB, the failure of SCSi to execute a consultant contract for Mr. Quinton until a year after his date of hire suggested a lack of an arm’s-length relationship. No written agreement setting compensation, duties and performance standards existed as is required by the federal cost principles for consultant costs to be allowed.⁵ Furthermore, Ms. Quinton’s alleged absence on the board failed to support SCSi’s argument that the hiring was devoid of conflicts. Rather, the DAB found that Ms. Quinton ran SCSi without meaningful board participation because SCSi failed to submit board meeting minutes reflecting its decisions and filed conflicting corporate documents.

Lastly, SAMSHA’s knowledge of SCSi’s plans to hire the president’s brother did not absolve SCSi from its responsibility to document that the hiring was conducted as an arm’s-length transaction, free from Ms. or Mr. Quinton’s influence.

SCSi Violated Cost Principles

SAMHSA argued that SCSi violated the federal cost principles by hiring Mr. Quinton as a consultant when he was an officer of the SCSi board. The federal cost principles codified at 2 C.F.R. Part 230 (formerly OMB Circular A-122) set rules for which costs may be charged to federally-funded grants to nonprofits. They prohibit the hiring of a consultant or any person providing professional services who is also an officer or employee of the grantee.⁶ Because the DAB found that the project director was an officer of SCSi at the time he was hired as a consultant, federal funds could not be used to pay him as a consultant.

SCSi Failed to Obtain Prior Approval to Hire a Consultant

SAMHSA asserted that SCSi failed to follow the year one grant budget by hiring the project director as a consultant, rather than as an employee. SCSi contended that the hiring did not require prior approval because at the time SCSi was not on “high risk status” and the “reallocation of funds did not exceed 25% of the total grant award amount.” Moreover, SCSi argued that SAMHSA approved the shift from employee to consultant in the budget for the two years following the first grant year.

The DAB explained that the federal uniform administrative requirements for grants provide that “recipients shall obtain prior approvals from the HHS awarding agency for...[the] transfer or contracting out of any work under an award.”⁷ The DAB further found that prior approval was required for the first year of the grant even if it were proven that SAMHSA approved the shift in later years.

Moreover, the DAB explained that even if SAMHSA approved the shift to consultant in later years, this approval did not change the fact that SAMHSA had not given approval for the shift the first year and that SCSi failed during the first year to follow the federal cost principles’ requirement that employee costs be documented. The cost principles require documented payrolls approved by a responsible official of the organization and personnel activity reports that: (1) “reflect[] the distribution of activity of each [grant] employee”; (2) “reflect an after-the-fact determination of the actual activity of each employee”; (3) “account for the total activity for which employees are compensated”; (4) are “signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee.”⁸ The DAB noted that

following these requirements is particularly important, where, as in SCSI’s case, an employee does not spend 100% of his/her time on the grant. According to the DAB, requiring a part-time project director to be treated as an employee, particularly during the first year of a grant, significantly enhanced SAMHSA’s ability to ensure that grant funds were properly charged and allocated to the grant. (See end notes on page 19)

.....
Lessons Learned

- Ensure that your organization has a conflict of interest policy in place that prohibits officers and employees from providing professional services paid for with federal funds.
 - Require board members to regularly sign and update disclosure forms for any possible conflicts of interest.
 - Appoint a board committee, such as a governance committee, to review the disclosure forms at least once annually.
 - Ensure that board minutes accurately reflect actions taken.
 - Double check the consistency of all corporate filings.
 - Read grant agreements, federal uniform administration requirements and cost principles to understand which changes from the budget require prior approval.
 - Have written consultant agreements.
-

Termination

(continued from page 7)

timeframes stated above. Furthermore, the Head Start regulations state that “[i]f an Early Head Start or Head Start grantee fails to correct a deficiency, either immediately, or within the timeframe specified in the approved Quality Improvement Plan, the responsible HHS official will issue a letter of termination or denial of refunding.”³

The DAB concluded that even if the Act is ambiguous, the regulations put Voorhees on notice that its Head Start funding would be terminated if it failed to correct the deficiency identified by ACF within the time period specified in its approved QIP. The DAB supported its conclusion with a prior DAB decision holding that “[a]s a matter of law, later steps to correct deficiencies still outstanding after a grantee has been given an opportunity to correct cannot remove authority from ACF to terminate based on the failure to timely correct.”⁴

ACF Did Not Waive Its Right to Terminate Funding

Voorhees contended that ACF waived its right to terminate Voorhees’ EHS funding in the following two ways: (1) by failing to provide timely reports to Voorhees on the April 2008 and October 2009 reviews and (2) by approving Voorhees’ application for continued funding on August 19, 2010.

ACF’s Failure to Provide Timely Reports Is Not a Waiver of Its Rights

In arguing that ACF waived its right to terminate Voorhees’ funding, Voorhees relied on a section in the Head Start Act requiring the Secretary of HHS to publish a summary report on the findings of reviews and outcomes of QIPs done during the fiscal year no later than 120 days after the end of the fiscal year.⁵ Voorhees reasoned that it was logical to assume that ACF would have to submit its report to the grantees within that same time period.

.....
: “The DAB found that ACF’s 10- or 11-month :
: delay in providing Voorhees with the review :
: report was not reasonably timely or prompt.” :
:

The DAB found that Voorhees’ connection between the timing of a public summary of all Head Start review findings and the timing of individual reports to grantees was not an obvious one. Rather, the more relevant provision is the one that requires review findings to be presented to the grantee in a “timely manner.”⁶ Moreover, the Head Start regulations state that an HHS official will “notify the grantee promptly, in writing of any deficiencies found in a review.”⁷

The DAB found that ACF’s 10- or 11-month delay in providing Voorhees with the review report was not reasonably timely or prompt. However, relying on a prior DAB decision, the DAB held that nothing in the Head Start statute or regulations makes timely issuance of a grantee review report a prerequisite to termination. The DAB concluded that even though it is “important that ACF act promptly” when issuing grantee review reports, a delay in doing so does not justify the grantee’s failure to correct deficiencies.

ACF’s Approval of Continued Funding Does Not Preclude a Funding Termination

Voorhees argued that ACF waived its right to terminate the grant because it approved Voorhees’ refunding application on August 19, 2010, before issuing the August

(Continued on page 18)

A sampling of agendas for a high level finance committee includes:

- **Develop key guidelines** and assumptions before budget planning begins.
- **Analyze trends** in income sources.
- **Discuss changes** in types and reliability of income.
- **Hold in-depth discussions** of factors that will influence budgets for the next three years.
- **Review and discuss** the organization's financial policies. Are these policies adequate in light of the organization's size, complexity, and life-cycle stage? This review requires more than applying simplistic "best practices" from another organization.
- **Evaluate the pros and cons** of buying vs. leasing a new facility and the impact on cash flow, capital campaign needs, depreciation, and costs of ownership.

A more engaged finance committee will require a different role for the CFO or finance director - one that may not be as easy as working with a more perfunctory committee. The payoff in the quality of review, understanding, and financial governance will be worth it. For the committee to work well, the finance committee chair and CEO or CFO need to invest time in planning meetings, setting goals and expectations for the committee, and preparing good information for discussion. These activities will help inform board members when it comes time for them to make the final financial decisions.

Kate Barr (kbarr@nonprofitsassistancefund.org, 612-278-7182) is executive director of Nonprofits Assistance Fund, a nonprofit community development organization that helps build financially healthy nonprofits, offering workshops and providing financing for working capital, cash flow, equipment, and facilities projects (www.nonprofitsassistancefund.org). She earned her master's degree from Hamline University, where she currently teaches a nonprofit management course.

The Legal Update Newsletter is part of the National T/TA Strategy for Promoting Exemplary Practices and Risk Mitigation for the CSBG program and is presented by Community Action Program Legal Services, Inc. (CAPLAW) in the performance of the U.S. Department of Health and Human Services, Administration of Children and Families, Office of Community Services Cooperative Agreement Number 90ET0429 and 90ET0432. Any opinion, findings, and conclusions, or recommendations expressed in the call are those of the presenter(s) and do not necessarily reflect the views of the U.S. Department of Health and Human Services, Administration of Children and Families.

End Notes

Revised Americans with Disabilities Act Regulations

1. 29 C.F.R. § 1630.2(g).
2. Appendix to Part 1630—Interpretive Guidance on Title I of the Americans With Disabilities Act.
3. 29 C.F.R. § 1630.2(i).
4. 29 C.F.R. § 1630.2(i)(2).
5. Appendix to Part 1630—Interpretive Guidance on Title I of the Americans With Disabilities Act.
6. 29 C.F.R. § 1630.2(j)(1).
7. Appendix to Part 1630—Interpretive Guidance on Title I of the Americans With Disabilities Act.
8. 29 C.F.R. § 1630.2(j)(3).
9. 29 C.F.R. § 1630.2(j)(1)(ii).
10. Appendix to Part 1630—Interpretive Guidance on Title I of the Americans With Disabilities Act.
11. 29 C.F.R. § 1630.2(j)(4).
12. 29 C.F.R. § 1630.2(g)(3).
13. 29 C.F.R. § 1630.2(j)(1)(ix).
14. 29 C.F.R. § 1630.2(g)(3).

May Employees Lend a Helping Hand?

1. 29 C.F.R. § 785.44.
2. See U.S. Department of Labor ("DOL") Wage and Hour Division Opinion Letter (Sep. 30, 1999) and DOL Wage and Hour Field Operations Handbook §10b03(c).
3. 29 U.S.C. § 203(e)(4)(A)(i). 29 C.F.R. §§ 553.101 and 553.103.
4. *Brooklyn Savings Bank v. O'Neill*, 324 U.S. 697, 707 (1945).
5. See DOL Wage and Hour Division Opinion Letter No. FLSA2006-4 (January 27, 2006).

DAB Disallowance

1. Complete decision can be found at <http://www.hhs.gov/dab/decisions/dabdecisions/dab2333.pdf>.
2. See 45 C.F.R. § 74.42.
3. HHS Grants Policy Statement, page ii and Section I-3.
4. HHS Grants Policy Statement, Section II-7.
5. See 2 C.F.R. Part 230, Att. B, ¶ 37.b.8 stating that the allowability of consultant fees depends on a number of factors including the "[a]dequacy of the contractual agreement of the services (e.g., description of the services, estimate of time required, rate of compensation, and termination provisions)."
6. See 2 C.F.R. Part 230, Att. B, ¶ 37.1.
7. See 45 C.F.R. § 74.25(c)(7).
8. See 2 C.F.R. Part 230, Att. B, ¶ 8.m.13.

DAB Grant Termination

1. Complete decision can be found at <http://www.hhs.gov/dab/decisions/dabdecisions/dab2351.pdf>.
2. 42 U.S.C. § 9836A(e)(1)(C).
3. 45 C.F.R. § 1304.60(f).
4. *Babyland Family Services, Inc.*, DAB No. 21209, at 21 (2007).
5. See 42 U.S.C. § 9836A(f)(1).
6. See 42 U.S.C. § 9836A(c)(4)(A).
7. 45 C.F.R. § 1304.60(b).
8. 45 C.F.R. § 1303.14(f)(1).

Make Good Use of the Treasurer & Finance Committee

Nonprofit World • Volume 27, Number 2 March/April 2009 Published by the Society for Nonprofit Organizations 5820 Canton Center Road, Suite 165, Canton, Michigan 48187 734-451-3582 • www.snpo.org

Robinson, Bridget, "Financial Stability: An Impossible Dream?", Nonprofit World, Vol. 15, No. 3. Ruiz, Rosemarie, "Are You Fulfilling Your Financial Trust?", Nonprofit World, Vol. 17, No. 1.

These resources are available at www.snpo.org/members. Also see Learning Institute programs on-line: Board Governance (www.snpo.org/li).

Helping Boards be Responsible Fiscal Stewards

Chris Jenkins is managing director for knowledge and advocacy at the Nonprofit Finance Fund. Originally appeared in *Philanthropy Journal* June 10, 2010 <http://www.philanthropyjournal.org/resources/managementleadership/helping-boards-be-responsible-fiscal-stewards>

Visitors to this Web site may copy and distribute news published here if that use is free and non-commercial and if the following credit is given: "Reprinted with permission of *Philanthropy Journal*, www.philanthropyjournal.org"