

# CAPLAW<sup>update</sup>



## How the Supreme Court's Landmark Ruling on Same-Sex Marriage Affects Employee Benefits

By CAPLAW Legal Staff

In June 2013, the United States Supreme Court struck down Section 3 of the federal Defense of Marriage Act (DOMA) in *United States v. Windsor*.<sup>1</sup> Section 3 defined "marriage," for purposes of federal law, as the legal union of one man and one woman as husband and wife and "spouse" as a person of the opposite sex who is a husband or wife.<sup>2</sup> DOMA thus denied married same-sex couples recognition as such under more than 1,000 federal statutes that use marital and spousal status as a prerequisite to various rights, benefits and responsibilities.<sup>3</sup> Among other things, the *Windsor* decision has an important impact on employee benefits provided to spouses in a same-sex marriage.

Immediately following the *Windsor* decision, it was clear that rights under employee benefit plans would be greatly expanded for same-sex spouses living in states

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## Avoiding a Head Start Termination

By Cody Friesz, CAPLAW

With the implementation of the new Head Start designation renewal regulations, it is more important than ever for Community Action Agencies (CAAs) with Head Start programs to understand and avoid actions that resulted in other CAAs losing their Head Start funding. This article reviews three U.S. Department of Health and Human Services (HHS) Departmental Appeals Board (DAB) decisions that upheld Head Start terminations, discusses ways in which Head Start grantees failed to comply with the HHS regulations, and proposes actions for avoiding similar mistakes.

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# DOMA and Employee Benefits

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member. Prior to the *Windsor* decision, the FMLA did not protect employees who took leave relating to their same-sex spouses. Since the definition of spouse for purposes of the FMLA is determined by the state in which the employee resides, now employees who live in states that recognize same-sex marriage, will be eligible for the different types of FMLA leave relating to the care or military service of a same-sex spouse.<sup>15</sup> However, employees who live in states that do not recognize same-sex marriage will not be entitled to FMLA leave under the same circumstances.

## Action Steps for Employers

The *Windsor* decision significantly changes the administration of employee benefits for employees with same-sex spouses. Employers should continue to watch for further guidance regarding the impact of the decision on how the administration of employee benefit. In the meantime, employers should:

- Review benefit plan documents to determine how they define the term “spouse” and whether that definition is consistent with the employer’s intentions. Make any necessary or desired plan amendments and update all forms as needed.
- Work with their payroll department or service to ensure that employees whose same-sex spouses are enrolled in the organization’s health plan are not being taxed on the employer’s share of health insurance premiums for their spouses and that the employee’s share of premiums is being paid on a pre-tax basis if the employer has a cafeteria plan that provides spousal coverage.
- Disseminate the COBRA General Notice, along with other disclosures required to be provided to spouses (for example, the annual funding notice for defined benefit retirement plans), to the same-sex spouses of health and qualified retirement plan participants.
- Determine enrollment options for same-sex spouses if they are covered by the health benefits plan.
- Communicate changes in health and qualified retirement plans to participants (for example, through a summary of material modifications). The communications should include a description of each change and its effective date.
- Consider how employee benefit plans will treat civil unions and domestic partnerships in light of expanding coverage and recognition of same-sex spousal benefits.<sup>16</sup>

Because of the complexities of employee benefits laws, CAPLAW recommends consulting with an experienced employee benefits attorney when making changes to benefit plan documents and administration.

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## Avoiding Head Start Termination

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### Overview of Head Start Monitoring Requirements

The Head Start Act requires that HHS conduct a full review of every Head Start grantee once every three years.<sup>1</sup> During this review, if HHS finds any “deficiencies” the grantee must be notified in a timely manner.<sup>2</sup> A deficiency is a systemic or substantial material failure in an area of performance that involves, among other things, a failure to comply with standards related to early childhood development and health services, family and community partnerships, or program design and management; the misuse of funds; and failure to meet Federal and State requirements that the grantee is unwilling or unable to correct.<sup>3</sup> After receiving notification of one or more deficiencies, the grantee has a specified amount of time, never to exceed a year, to correct the identified deficiencies.<sup>4</sup> A follow-up review will then be conducted.<sup>5</sup> If that review shows that one or more of the deficiencies has not been corrected, HHS must terminate the grantee’s Head Start award.<sup>6</sup>

### Providing Accurate, Current and Complete Disclosure of Financial Results

All Head Start grantees must comply with HHS’s codification of the uniform administrative requirements (OMB Circular A-110).<sup>7</sup> In turn, these regulations require all nonprofit grantees to establish a financial management system that provides “accurate, current and complete disclosure of the financial results” of federally funded programs.<sup>8</sup> The uniform administrative requirements also incorporate the federal cost principles (OMB Circular A-122)<sup>9</sup> for determining which costs are allowable

“...regulations require all nonprofit grantees to establish a financial management system...”

under an award.<sup>10</sup> In a recent decision,<sup>11</sup> the DAB upheld a termination of a North Carolina CAA's Head Start grant for failure to establish a financial management system that provides accurate financial results based on the CAA having overstated its claim for indirect costs and non-federal share due to improper application of the federal cost principles.

### Indirect Costs

The federal cost principles applicable to all nonprofits that receive federal grants distinguish between direct and indirect costs.<sup>12</sup> A cost that can be identified with a particular cost objective is a direct cost,<sup>13</sup> while a cost incurred for a common or joint objective is an indirect cost.<sup>14</sup> To charge indirect costs to a federal grant, a grantee must have an indirect cost rate that is negotiated with and approved by the federal agency.<sup>15</sup> An indirect cost rate is generally established by dividing allowable indirect costs by total direct costs.<sup>16</sup> That rate is then applied to the cost objective's distribution base (such as actual total direct costs, actual direct salaries, etc.) to determine the indirect costs that may be charged to a particular grant.<sup>17</sup> The DAB found that the North Carolina CAA overstated its indirect costs by using a direct cost base that exceeded its actual base—instead of using actual salaries and wages, the CAA used budgeted salaries and wages.

Additionally, the CAA used an indirect cost rate that was greater than the provisional rate approved for the program year. A provisional rate is a temporary indirect cost rate used for a specified period pending approval of a final rate by the federal government.<sup>18</sup> In its defense, the CAA argued that, since the provisional rate was not final, it could use the higher rate it selected. However, the DAB explained that the federal cost principles require federal grantees to use their provisional rates until a final rate is established through an amended rate agreement.<sup>19</sup>

When allocating indirect costs to a Head Start grant, it is important to remember:

- Indirect costs may only be allocated to a Head Start grant using an indirect cost rate approved by HHS.
- When a grantee has a provisional rate, that rate must be used until the federal agency has issued a final rate for the period.
- Actual, not budgeted, direct costs must be used when calculating indirect costs that will be charged to a Head Start grant.

### Non-Federal Share

In the decision involving the North Carolina CAA, the CAA's inaccurate valuation of donated space resulted in its non-federal share being overstated. The DAB interpreted this overstatement as one indication that the grantee's financial management system did not provide accurate financial disclosures.

When donated space is used as part of a match requirement, the value of the space cannot exceed the fair rental value of comparable space. The fair rental value must be established

"A 'less-than-arms-length' agreement is one between related parties where one party can exercise control or substantial influence over the other party."

by an independent appraisal of a comparable, privately owned space.<sup>20</sup> However, fair rental value cannot be used if the space is owned by the CAA or leased under a "less-than-arms-length" agreement. A "less-than-arms-length" agreement is one between related parties where one party can exercise control or substantial influence over the other party. For example, an agreement between a CAA and a nonprofit real estate holding corporation, when

both are under the control of common directors or officers, is a less-than-arms-length agreement. With less-than-arms-length arrangements, the use of the space must be reflected as either a "use allowance" or "depreciation cost" proportional to the space used, rather than as fair rental value.<sup>21</sup> Additionally, any fair rental value, use allowance or depreciation cost used toward the non-federal share must account for and exclude property improvements paid for with federal funds.<sup>22</sup>

The North Carolina CAA used a rental value that exceeded the fair rental value as determined by an independent appraisal. Further, it owned one of the buildings; thus, its use of that building should have been reflected as a use allowance or depreciation cost, which was significantly less than the value used. Finally, the second building counted towards the non-federal match had been renovated using Head Start funds. The CAA failed to explain how it could claim the full fair rental value of that second building towards its non-federal share when federal funds had been used to make improvements to the space.

There are a number of important rules and standards to keep in mind when accounting for the value of rented or donated space:

- The value of space donated by an unrelated third party cannot exceed the fair rental value of comparable space in a privately owned building in the same locality as determined by an independent appraiser.
- When a grantee owns a building or leases the property through a less-than-arms-length agreement and donates space to a particular project, the value of the space used to calculate the project's non-federal share cannot exceed the use allowance or depreciation costs associated with that space.
- Prior to using federal funds for building improvements, work with the funding source to determine what the federal share in the building will be. Consider how this will affect fair rental value and use and depreciation allowances.
- When federal funds have been used to improve a particular space, account for the federal share in the building when determining the rental value, use allowance, or depreciation to be charged to the grant.

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# Avoiding Head Start Termination

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## Ensuring Effective Control Over and Accountability for Federal Funds

It is not enough that a grantee's financial management system provide accurate financial disclosures. The system must also provide "effective control over and accountability for all funds."<sup>23</sup> The DAB found that a Virginia CAA did not meet this requirement when it failed to follow its own leave policies.<sup>24</sup>

The CAA's leave policy allowed employees to receive up to 45 hours of donated sick leave when they had exhausted their leave balances. It also prohibited an employee on extended leave from accruing additional leave until he/she returned to "active leave status." However, during reviews, it was discovered that an employee donated 600 hours of accrued sick leave to two colleagues, both had positive sick leave balances at the time; and another employee accrued sick and annual leave while on extended leave.

To ensure effective control over and accountability for federal funds, grantees should:

- Regularly review personnel and financial policies to ensure they reflect current organizational practices. When policies and practices are inconsistent, action should be taken to update the policy or correct the practice.
- Train all employees on the policies and consider implementing random checks to ensure they follow the required procedures.

## Managing Cash Flow and Use of Federal Funds

Federal administrative requirements provide that cash advances must be limited to the minimum amounts needed, and be timed to match the immediate cash requirements of the grantee in carrying out the project.<sup>25</sup> The Virginia CAA, however, failed to comply with this requirement. It had drawn down funds, on two separate occasions, to pay its payroll tax liabilities, but failed to remit payment to the IRS in a timely manner. During both its initial and follow-up reviews, the CAA had an outstanding tax liability in excess of \$85,000.

Further, the CAA had drawn down funds in excess of its Head Start expenses. The finance director admitted that the excess drawdowns were used to cover shortfalls elsewhere in the organization due to cash flow problems. However, the DAB explained that the uniform administrative requirements require drawdowns to meet the "cash requirements of the [grantee] in carrying out the purpose of the approved program or project."<sup>26</sup> The

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DAB found that grantees cannot use federal funds from one program to meet shortfalls in another.

Moreover, even though the DAB did not address the application of the federal cost principles (OMB Circular A-122, 2 C.F.R. Part 230) in its decision, the principles specifically prohibit all federal grantees, including Head Start grantees, from shifting costs between federal funding sources to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of an award.<sup>27</sup>

To comply with applicable payment and cash flow requirements, CAAs should:

- Develop policies and procedures that minimize the time that elapses between drawing down cash and disbursing the funds to pay for program expenses, such as payroll taxes.
- Ensure that federal funds are being used only for their intended purpose. Funds from one federally funded program cannot be used to meet cash shortfalls elsewhere in the organization, even if the shortfall is in another federally funded program or the organization intends to replace the funds at a later date.<sup>28</sup>

## Implementing Internal Controls and Ongoing Monitoring

In another DAB decision,<sup>29</sup> the Head Start program of an Arkansas CAA was terminated due to the CAA's failure to establish and implement procedures for ongoing monitoring to ensure effective implementation of federal regulations.<sup>30</sup> Here, a number of findings indicated that the CAA failed to establish and implement monitoring procedures in particular, the DAB found that: (1) the organization did not have a policy and procedure for monitoring staff qualifications and training and completion of health examinations and criminal record checks; (2) the CAA's safety maintenance schedule did not include guidelines for identifying safety issues, monitoring first aid kits and maintaining medication storage; (3) an ongoing monitoring procedure for the transportation service area had not been implemented; and (4) the organization failed to ensure Head Start governance requirements were met, such as including individuals with the necessary expertise on the board.

The ongoing monitoring provision is extremely broad and requires grantees and their governing boards to have procedures for ensuring proper implementation and compliance with regulations. For example, grantees must have internal financial controls, policies that ensure staff members are qualified and properly trained, procedures for facility maintenance and repair, etc.

To ensure that it is carrying out proper monitoring functions, a CAA should consider:

- Using the Head Start Monitoring Protocol as a guide for periodically checking different aspects of its program, including implementing checklists based

on the protocol that address proper maintenance of facilities.

- Regularly referring to the Health and Safety Screener and Governance, Leadership and Oversight Capacity Screener required for five year Head Start grants to ensure and maintain compliance.
- Conducting random checks of staff files to ensure that staff members are properly trained and have completed health examinations and criminal record checks.
- Monitoring credit card transactions as part of the financial reports submitted to the board to ensure that charges are reasonable, necessary and allowable and that credit cards are used only for authorized purposes.
- Ensuring bus drivers employed by Head Start programs have commercial driver's licenses, a medical examination, and a driving-record check, as well as a criminal record check.
- Adopting proper financial internal controls, including the appropriate segregation of duties. For example, payroll processing and the ability to draw down funds should not be vested in the same person.
- Monitoring board activity to ensure the board executes its responsibilities, including, among other things, approving the annual Head Start self-assessment, reviewing personnel policies regarding hiring and terminating key management staff, and reviewing reports on program enrollment and meals and snacks served to children.
- Using a board governance committee to oversee board composition and recruitment to ensure that the board includes at least one member with a background and expertise in fiscal management or accounting, at least one member with a background and expertise in early childhood education and development, and at least one member who is a licensed attorney familiar with issues that come before the governing body. If a grantee is unable to find individuals to fill these requirements, it may use consultants. However, the grantee should document that it sought and was unable to find individuals willing to serve on the board who could fulfill the above requirements. Grantees should also be aware that there are other board composition requirements, for example, including a current or former Head Start parent.

## Insight into Opposing a Termination

These three DAB decisions also instruct CAAs on the arguments opposing Head Start terminations that the DAB finds unconvincing. One of these arguments focused on the time frame within which corrective actions must be developed and implemented. The DAB explained in two of the decisions that all deficiencies must be corrected

“...evidence of a grantee’s compliance after the correction period, even if it occurs before the DAB hearing, is not sufficient.”

by the end of the correction period prescribed by HHS.<sup>31</sup> So, at the close of the correction period, when one CAA proposed changes to ensure future compliance and another had adopted, but not implemented, the required procedures, the DAB found that such actions were not enough to prevent termination. To prevent the termination, both CAAs needed to have implemented the policies, procedures and changes before the correction period ended. Further, the DAB found

that evidence of a grantee’s compliance after the correction period, even if it occurs before the DAB hearing, is not sufficient.

The DAB explained further that meeting the general purpose and goals of the Head Start program is not enough to save a grantee’s funding. Grantees are required to comply with the Head Start statute and **ALL** regulations applicable to the Head Start program, including the uniform administrative requirements and federal cost principles. Arguing that termination will result in children being deprived of vital services does not excuse a grantee from complying with those requirements.

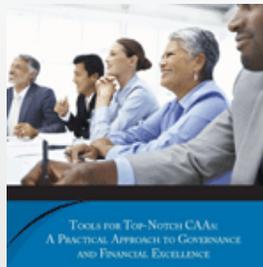
Finally, allegations of a reviewer’s bias require substantial support. Even when a grantee alleges that a reviewer is biased, the DAB will find the reviewer’s findings and testimony to be reliable when it is undisputed and supported by unrefuted factual findings. Thus, if a CAA believes that its Head Start grant was terminated due to a reviewer’s bias, it must provide evidence that shows the reviewer’s findings are inconsistent with the facts. If such evidence cannot be presented, a bias argument is unlikely to succeed.

Ensuring compliance with the Head Start Act and regulations is an ongoing process. CAAs must remain informed on the changing requirements and continually monitor their programs. These steps, and the others discussed in this article, will help CAAs avoid future Head Start terminations.

*(See endnotes on page 22)*

## CAPLAW GUIDEBOOK

### Tools for Top-Notch CAAs



*A Practical Approach to Governance and Financial Excellence*

This six-section toolkit is intended to assist boards and management in their collaborative efforts to build well-governed and effective CAAs. [Learn more and download!](#)

# Article End Notes

## How the Supreme Court's Landmark Ruling on Same-Sex Marriage Affects Employee Benefits

1. *U.S. v. Windsor*, 133 S. Ct. 2675 (2013).
2. Codified as 1 U.S.C. § 7.
3. *Windsor*, 133 S. Ct. at 2679.
4. See 26 U.S.C. § 2056(a).
5. *Windsor*, 133 S. Ct. at 2695.
6. *Id.* at 2693-2694.
7. *Id.* at 2693.
8. *IRS Answers to Frequently Asked Questions for Individuals of the Same Sex Who are Married Under State Law*, <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples>.
9. *DOL EBISA FAQs About Portability Of Health Coverage And HIPAA*, [http://www.dol.gov/ebsa/faqs/faq\\_consumer\\_hipaa.html](http://www.dol.gov/ebsa/faqs/faq_consumer_hipaa.html).
10. IRS Notice 2014-1 (issued December 16, 2013), <http://www.irs.gov/pub/irs-drop/n-14-01.pdf>.
11. *Id.*
12. *Id.*
13. *Id.*
14. IRS Revenue Ruling 2013-17, <http://www.irs.gov/pub/irs-drop/rr-13-17.pdf>, and *IRS Answers to Frequently Asked Questions for Individuals of the Same Sex Who are Married Under State Law*, <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples>.
15. *DOL Fact Sheet #28F: Qualifying Reasons for Leave under the Family Medical Leave Act*, <http://www.dol.gov/whd/regs/compliance/whdfs28f.htm>.
16. See *IRS Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions*, <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions>.

## Avoiding a Head Start Termination

1. 42 U.S.C. § 9836a(c)(1).
2. 42 U.S.C. § 9836a(e)(1)(A).
3. 42 U.S.C. § 9832(2)(A).
4. 42 U.S.C. § 9836a(e)(1)(B).
5. 42 U.S.C. § 9836a(c)(1)(C).
6. 42 U.S.C. § 9836a(e)(1)(C); 45 C.F.R. § 1307.3.
7. Uniform Administrative Requirements for Awards and Subawards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations, OMB Circular A-110 codified by the

Department of Health and Human Services at 45 C.F.R. Part 74.

8. 45 C.F.R. §§ 74.21(b)(1).
9. Cost Principles for Non-Profit Organizations, OMB Circular A-122 codified at 2 C.F.R. Part 230.
10. 45 C.F.R. § 74.27(a).
11. New Hanover County Community Action, Inc., DAB No. 2478 (2012).
12. See 2 C.F.R. Part 230, App. A, ¶¶ B-C.
13. 2 C.F.R. Part 230, App. A, ¶ B.1. A cost objective is a particular work unit, such as a division, grant, project, program, etc., for which information regarding costs related to the unit is collected, See *Id.* at App. A, ¶ E(1)(g).
14. *Id.* at App. A, ¶ C(1).
15. *Id.* at App. A, ¶¶ D-E.
16. *Id.* at App. A, ¶ D.
17. *Id.*
18. 2 C.F.R. Part 230, App. A, ¶ E.1.e.
19. See 2 C.F.R. Part 230, App. A, ¶¶ D.2.a, D.2.d, & E.1.a.
20. 45 C.F.R. § 74.23(h)(3).
21. 2 C.F.R. Part 230, App. B, ¶ 11.a; 2 C.F.R. Part 230, App. B, ¶ 43.b, c.
22. See 45 C.F.R. § 74.2 (defining federal share to include the percentage of property improvement costs paid for with federal funds).
23. 45 C.F.R. § 74.21(b)(3).
24. H.O.P.E. Community Services, Inc., DAB No. 2487 (2012).
25. 45 C.F.R. § 74.22(b)(2).
26. *Id.* (emphasis added).
27. 2 C.F.R. Part 230, App. A, ¶ A.4.b.
28. See 45 C.F.R. § 74.22(b)(2) and 2 C.F.R. Part 230, App. A, ¶ A.4.b.
29. Southwest Arkansas Development Council, Inc., DAB No. 2489 (2012).
30. 45 C.F.R. § 1304.51(i)(2).
31. 45 C.F.R. § 1304.60(c).

## DAB Disallowance Lessons: Document and Use Funds for Specified Activities

1. East Chicago Community Health Center, DAB No. 2494 (2013).
2. Uniform Administrative Requirements for Awards and Subawards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations, OMB Circular A-110 codified by the Department of Health and Human Services at 45 C.F.R.