



## **DAB Decisions Stress Importance of Obtaining Prior Approval for Grant-Related Changes**

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Two decisions from the United States Department of Health and Human Services (HHS) emphasize the importance of obtaining prior approval for certain actions relating to grant awards. The first decision involves the disallowance of grant funds based on the grantee's failure to obtain approval from the Administration of Children and Families (ACF) prior to transferring the funds to a different project. The second decision involves the termination of two grant awards based on the grantee's failure to obtain prior approval for post-award organizational changes. On appeal, the HHS Departmental Appeals Board (DAB) upheld both disallowances.

### ***Florence Villa Community Development Corporation, DAB No. 2198 (Sept. 2008)*<sup>1</sup>**

#### **Background**

In May 2004, Florence Villa Community Development Corporation (FVDC) applied for a competitive Community Economic Development (CED) grant authorized by the Community Services Block Grant Act. The program announcement for the CED grant stated that the grants were to be awarded "to encourage rural and community development corporations to create projects intended to provide employment and business development opportunities for low-income people through business or commercial development." In September 2004, FVDC was awarded a grant in the amount of \$700,000, \$500,000 of which was to be used as a loan to facilitate the expansion of Cypress Gardens Adventure Park, LLC (Cypress Gardens).

FVDC reported in its semi-annual program progress report for the period July 1, 2006 through December 30, 2006 that Cypress Gardens had filed for bankruptcy; however, FVDC did not mention having received loan repayments from Cypress Gardens before the bankruptcy filing. In August 2007, a Florida congressman contacted the director of the federal Office of Community Services (OCS) in response to an email from a constituent (a former FVDC executive director) about FVDC's expenditure of federal funds, particularly in connection with its launch of a plant nursery and its project to create jobs at Cypress Gardens, which had declared bankruptcy. Upon investigation, OCS learned that FVDC had recovered \$200,000 in loan repayments from Cypress Gardens before Cypress Gardens declared bankruptcy and used the repaid funds as working capital to support the growth of its plant nursery project. According to FVDC, the nursery project, like the Cypress Gardens project, was designed to provide employment for low-income residents in the area served by FVDC. FVDC alleged that its staff had contacted its ACF program specialist about reprogramming the loan repayments and that she had

informed FVDC that “so long as the loan repayment funds were utilized to further the ‘economic development activities’ of the organization, no regulatory requirements precluded FVDC from utilizing the repaid funds in said manner.” In March 2008, OCS disallowed the \$200,000 because FVDC had not obtained prior written approval from the ACF Office of Grants Management to transfer the recovered loan funds to a different project.

### **Prior Written Approval Requirement**

FVDC argued that it reapplied the funds recovered from Cypress Gardens to its plant nursery project only after its executive director had discussed the plan with the ACF program specialist for the CED grant. FVDC submitted an affidavit from its executive director attesting that the ACF program specialist “approved, or at least offered no objection to the application of the Cypress Gardens funds to the Nursery project.” The executive director further attested in the affidavit that he believed the use was “in keeping with both the spirit and intent of both the Nursery and Cypress Gardens grants.”

The DAB rejected FVDC’s argument on the ground that the grant award’s terms and conditions, which specified that the grant was subject to HHS’s uniform administrative requirements for grants to nonprofit organizations,<sup>2</sup> placed FVDC on notice that it could not depend on oral discussions with the program specialist as prior approval for applying the funds to the plant nursery project. Specifically, the grant administrative requirements specify that grantees must obtain prior written approval for any budget revision resulting in a change “in the scope or the objective of the project or program.”<sup>3</sup> The grant administrative requirements also stipulate that approvals “shall not be valid unless they are in writing and signed by at least one” of the identified HHS officials.<sup>4</sup> The DAB found that FVDC failed to establish that ACF had given prior written approval for FVDC’s transferring the recovered loan amount to the plant nursery. The DAB further noted that the objective of the plant nursery was not the same as the Cypress Gardens, citing differences in the scope of the two projects.

### **Other Arguments**

OCS also contended that FVDC was also required to obtain prior approval under a provision of HHS’s grant administrative requirements that applies to intangible property (such as trademarks, copyrights, patents and patent applications, stock and lease agreements) and debt instruments (such as loans and notes). That provision specifies that a grantee must obtain prior approval before encumbering intangible property or debt instruments obtained with federal funds and that, when intangible property is no longer needed for its originally authorized purpose, it must be disposed of in accordance with the provisions that apply to the disposition of equipment acquired with federal funds (which require grantees to seek instructions from HHS on the disposition of the property and, if the grantee uses the property for other purposes, to compensate the federal government for its share of the property).<sup>5</sup> FVDC argued that because these provisions only address equipment, which is defined as “tangible nonexpendable personal property,”<sup>6</sup> they do not apply to the disposition of loan repayment proceeds. The DAB rejected this argument, noting that the reference to disposing of equipment is intended to illustrate the process a grantee should follow when disposing of intangible property or debt instruments. The DAB acknowledged that it was not clear that the loan repayment proceeds qualified as intangible property or a debt instrument, but concluded that it was unnecessary to address this issue since the disallowance was justified on other grounds.

FVDC also argued that the CED award notice explicitly allowed for the “draw down of federal funds” and, since the grant still retained its character as federal funds, then FVDC’s use of the funds for another HHS program was a proper “draw down” of the funds. The DAB explained that FVDC misconstrued the meaning of “draw down” which basically sets forth the mechanism by which funds

may be transferred consistently with the U.S. Treasury rules for minimizing the time elapsing between the transfer of funds from the U.S. Treasury to the grantee.

### ***Abstinence for Singles/Urban Community Action Network, DAB No. 2217 (Dec. 2008)***<sup>7</sup>

#### **Background**

In March and June 2006, Abstinence for Singles (AFS), a for-profit business in the process of reorganizing as a nonprofit, applied to ACF for a Community Based Abstinence Education (CBAE) grant and a Healthy Marriage Demonstration (HMD) grant. In September 2006, AFS obtained nonprofit status and received federal funding for its proposed CBAE and HMD projects. In January 2007, ACF conducted a site visit of AFS and noted numerous problems related to governance, board oversight, lack of legal counsel, absence of financial stability and lack of operating plans.

In May 2007, the executive director of AFS dissolved AFS and incorporated Urban Community Action Network (UCAN) to (1) implement ACF's recommendation that the name of the organization should better reflect both CBAE and HMD programs and (2) address ongoing problems with the incorporator of AFS who was threatening to dissolve the organization. AFS/UCAN failed to notify ACF of these changes, which ACF discovered on its second visit to AFS/UCAN in October 2007. The second site visit report stated that "upon completion of the site visit, an [ACF program specialist] communicated to UCAN that, due to the seriousness of the organizational and programmatic issues, continued CBAE funding for UCAN's program was in question." Also, ACF provided AFS/UCAN with a memorandum detailing 29 findings and recommendations, including lack of board approval for the dissolution, missing documentation showing the proper transfer of assets and liabilities from AFS to UCAN, and the failure of AFS/UCAN to notify the appropriate ACF offices of the dissolution of AFS and incorporation of UCAN, which immediately assumed responsibility for AFS' ACF grant funds and operations. In November 2007 a third site visit occurred during which ACF questioned AFS/UCAN about internal controls, and grantee documents and visited a grant program presentation.

In April 2008, ACF terminated AFS/UCAN's CBAE and HMD grants, citing information and evidence obtained during its three site visits and AFS/UCAN's failure to obtain the required pre-approval for the May 2007 organizational changes.

#### **Prior Written Approval Requirement**

HHS administrative requirements for grants to nonprofit organizations, which were included as part of the terms and conditions of both grant awards, require grantees to "obtain prior approval from the HHS awarding agency for the subaward, transfer, or contracting out of any work under an award."<sup>8</sup> DAB found that AFS/UCAN violated the transfer provision by (1) effectively transferring work under the CBAE and HMD awards from one legal entity to another when it dissolved AFS and incorporated UCAN and (2) failing to obtain ACF's prior approval for these organizational changes.

Conceding that ACF had not been given prior notification of these changes, ACF/UCAN argued that it had reorganized to prevent the incorporator from dissolving the organization and further contended that ACF had directed AFS to change the organization's name, which, according to ACF/UCAN, was all that occurred. The DAB rejected this argument on the basis that ACF only recommended that AFS consider renaming the organization to more accurately reflect its objectives. Moreover, the DAB observed that a name change did not occur under state law, which required a name change to be effectuated by an authorized amendment to the organization's articles of incorporation. The DAB also found that regardless of the underlying motive or intent of the organizational change, the dissolution of AFS,

incorporation of UCAN, and assumption of grant project operations by UCAN effectively transferred the work of the CBAE and HMD grant projects from one legal entity to another. ACF had no assurance that the remaining new entity would, without proper authorization or formal transfer, undertake and be answerable for the operating responsibilities of the grantee or maintain “effective control over and accountability for all funds.”<sup>9</sup> In fact, ACF was not informed of, but rather discovered during the second site visit, the fact that the necessary steps for a proper organizational change and transfer of grant work had not occurred, which consequently put federal funds at risk of misuse.

### **Grantor Notification**

AFS/UCAN also argued that if ACF considered the organizational change to be one requiring prior approval, ACF should have notified AFS/UCAN of this fact at its second and third site visits and given AFS/UCAN a chance to take corrective actions. The DAB explained that it is well settled by recent DAB decisions that ACF was not required to give AFS/UCAN an opportunity to correct noncompliance before imposing termination and that ACF was also not “precluded from terminating the award at a later date on the same basis on which it could have previously terminated the award.” The DAB found that ACF acted reasonably by undertaking a comprehensive evaluation of the information obtained during the three site visits and from the IRS, reviewing the grant applications, and conducting a conference call with AFS/UCAN before taking any formal action.

### **Successful Program**

Lastly, based on the information ACF obtained during its three site visits detailing AFS/UCAN’s problems and AFS/UCAN’s failure to notify ACF of its organizational changes, the DAB dismissed AFS/UCAN’s argument that ACF’s actions were unjustified in light of the success AFS/UCAN believed it had attained in delivering the grant programs.

### **Lessons Learned**

Grantees may glean the following lessons from these two DAB decisions:

- Develop a working knowledge of the grant terms and conditions, especially the federal awarding agency’s uniform administrative requirements for nonprofits<sup>10</sup> (or, if applicable, its uniform administrative requirements for state and local governments) included as part of a grant award.
- Seek prior approval for any major actions affecting a grant award, such as organizational restructuring or transfer of grant funds to a different project.
- If in doubt as to whether an action requires prior approval, never guess, consult the terms and conditions, etc. included as part of the grant award or contact the funding source.
- Ask that comments and directives from the funding source be placed in writing, especially conversations on which the grantee is basing its actions.

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<sup>1</sup> This DAB decision is available at <http://www.hhs.gov/dab/decisions/DAB2198.pdf>.

<sup>2</sup> See 45 C.F.R. Part 74 (“Uniform Administrative Requirements for Awards and Subawards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations,” the HHS version of Office of Management and Budget (OMB) Circular A-110).

<sup>3</sup> 45 C.F.R. § 74.25 (c), (1), (j).

<sup>4</sup> 45 C.F.R. § 74.25 (k).

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<sup>5</sup> 45 C.F.R. § 74.36(e).

<sup>6</sup> See 45 C.F.R. § 74.2.

<sup>7</sup> This DAB decision is available at <http://www.hhs.gov/dab/decisions/DAB2217.pdf>.

<sup>8</sup> 45 C.F.R. § 74.25 (c) (7).

<sup>9</sup> 45 C.F.R. § 74.21 (b) (3).

<sup>10</sup> See, e.g., 45 C.F.R. part 74 (HHS's uniform administrative requirements for grants to nonprofit organizations) and 45 C.F.R. part 92 (HHS's Uniform Administrative Requirements for Grants and Cooperative Agreements to State, Local, and Tribal Governments).