DAB Upholds Disallowance of Head Start Funds

Action for a Better Community, Inc., DAB No. 2104 (August 2007)[1]

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HHS's Administration for Children and Families' (ACF) decision to disallow over $900,000 in Head Start expenditures was upheld by HHS's Departmental Appeals Board (DAB) on the grounds that the expenditures were outside of the authorized purpose of the grant award, did not comply with a special condition of the grant, were not adequately documented, and/or exceeded the authorized grant amount.

Background

This decision deals with two separate grants, identified here as Grants A and B. Under Grant A, ACF awarded the grantee $500,000 in "restricted funds" to help purchase a property to be used for Head Start and Early Head Start program activities (the "Our Market" project). This award was subject to a special condition – the funds could not be spent until ACF approved architectural specifications and other materials required by 45 C.F.R. section 1309.10.[2] Since approval was not obtained by the end of the grant period, the Financial Status Report (FSR) submitted by the grantee for that period showed that none of the $500,000 had been spent or obligated. Shortly thereafter, the grantee submitted a proposal to ACF to extend the grant period by one year and to use the funds to renovate the facility, which would be purchased with nonfederal funds. ACF approved the proposal and determined that the proposal package satisfied the original award's special condition for prior approval.

Under Grant B, the grantee was authorized to spend $12,925,080 of federal funds on Head Start and Early Head Start program activities for the relevant one-year period. An FSR prepared by the grantee for Grant B stated that it covered that budgetary period plus an additional three months.[3] The grantee reported a negative unobligated balance of $534,158, meaning that it spent money in excess of its authorized grant award.

ACF Position

Grant A – ACF disallowed a total of $372,587 of the $500,000 grant. $168,000 was disallowed because it was spent on lease payments, a use not authorized by either the original grant award (for purchase of the property) or the amended award (for renovations of the property). Expenses amounting to $204,174 were disallowed for lack of documentation.

Grant B – ACF disallowed $534,157, the amount that the expended funds exceeded the authorized grant award for that year, according to the FSR.

Grantee Position

Grant A – The grant money spent on lease payments was really installment payments on the purchase price, as outlined in the purchase and sale contract for the property, which was included in the original funding application. This payment structure should be regarded as a capital lease, which is allowable under OMB Circular A-122. The balance of the disallowed expenses were documented in a chart of grant-related expenditures.

Grant B – The grantee argued that, despite the FSR, in fact there was no overexpenditure of Grant B funds. Accounting errors and overlapping budget periods caused it to mistakenly include expenditures from Grant A in the FSR for Grant B.

DAB Holding

Federal grantees have the burden of showing that expenditures are "allowable" under the award. For example, to satisfy this requirement, costs or expenses cannot exceed the allowable limit or be excluded under the award and they must be documented properly.[4]

Grant A – ACF properly disallowed the expenditures. Lease payments of $168,413 were an unauthorized use that did not comply with the special condition of the grant. Even if, as the grantee argued, the lease payments made during the original grant period could be properly categorized as installment payments on a purchase (the authorized purpose of the original grant), or an allowable capital lease, the payments were unallowable because expenditures made during the original grant period required prior approval by ACF of the architectural and other plans, which was not obtained. Moreover, the lease payments made after ACF approved the plans were also unallowable because the approval came along with an amendment of the grant award to change the purpose from purchase of the property to renovation of the property. DAB dismissed the grantee's argument that the fact that the notice of grant award for the amended grant contained a line item for a "facility purchase" of $500,000 indicated that the amended grant continued to be for the property purchase, rather than renovation, and therefore, given that ACF approval for the plans was now obtained, these lease payments, properly categorized as installment payments on a purchase, were allowable. The DAB concluded that, given that other sections of the award notice, the proposal, and correspondence clearly indicated that the purpose was to be changed to renovation of the facility, the reference to a "facility purchase" was a typographical error.

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The DAB also held that ACF properly disallowed $204,174 of Grant A, as there was no source documentation as to how it was spent.[5] The chart the grantee submitted listing expenditures did not suffice as an accounting record. Additionally, most of the payments listed on the chart, for "utilities, taxes, building maintenance, lease" were not allowable, as they were made for unauthorized purposes (lease payments, building maintenance) or after the budgetary period.

Grant B – ACF properly disallowed $534,158 on the basis of the signed FSR submitted by the grantee showing that amount as expenditures in excess of the authorized grant money. The DAB did not find that the grantee had submitted sufficient documentation to support its argument that an accounting error had caused it to

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against that employer, a Head Starts program's "educational institution" status may save the program a substantial sum of money. These savings may, in turn, be applied directly towards the services provided to Head Start children and families, or may be utilized to increase salaries of its school-year employees.

In any event, following the *Montgomery County* decision it seems clear that a significant number of Pennsylvania Head Start programs which were formerly not considered to be "educational institutions" by the UC board will now fit into the new definition of educational institution articulated by the court.[12] As a result, the employees of those Head Start programs, who have formerly been able to collect UC benefits during breaks, should expect to find themselves ineligible for benefits when they file this summer. Those Head Start programs most likely to fit within this new definition of "educational institution" include "direct-grantee" or "stand-alone" agencies whose primary focus involves providing educational services. Although not directly addressed in the *Montgomery County* holding, Community Action Agencies (CAAs) offering Head Start may also be affected by this decision. A key issue will be the nature and degree of the CAA's overall focus on education. While the *Montgomery County* case opens the door for the argument that a Community Action Group-run Head Start program focusing primarily on academic instruction may qualify as an "educational institution," those Community Action Groups whose focus as a whole is primarily related to non-academic social services may be able to distinguish themselves from the employer in the *Montgomery County* case and thereby avoid the "educational institution" designation.[13]

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1 *Montgomery County Head Start v. Unemployment Compensation Board of Review*, 938 A.2d 1137 (Pa. Cmwlth. 2007) *(Montgomery County)*.

2 43 P.S. §802.1 (2007).

3 Unemployment Insurance Program Letter (UIPL) #40-79 (August 13, 1979).

4 Unemployment Insurance Program Letter (UIPL) #41-97, 62 Fed. Reg. 60, 104-01 (November 6, 1997).

5 *Montgomery County*.

6 A "Community Action Group" is typically an umbrella corporation which runs a number of social service programs which may include a Head Start program. On the other hand, the term "direct grantee" is used by the court in *Montgomery County* to refer to a corporation whose primary function is the operation of a Head Start program. These agencies are also referred to in the Head Start community as "stand-alone" Head Start programs.

7 Specifically, the court cited *Easter Seal Society for Handicapped Children and Adults of Philadelphia, Bucks, Chester, Delaware and Montgomery Counties v. Unemployment Compensation Board of Review*, 720 A.2d 217 (Pa. Cmwlth. 1998).

8 *Employment Comm'n v. Child, Inc.*, 738 S.W.2d 56 (TX 1987).

9 *Industrial Comm'n v. Board of County Commissioners*, 690 P.2d 839 (CO 1984).

10 *In re Huntley*, 255 S.E.2d 574 (NC 1979).

11 *Simpson v. Iowa Department of Job Service*, 327 N.W.2d 775 (Iowa 1982).

12 This is especially evident since many of the factors articulated by the *Montgomery County* court as relevant in reaching the conclusion that the employer *does* qualify as an "educational institution" are present in all federally-funded Head Start programs.

13 The Pennsylvania UC Board recently issued a decision distinguishing a Community Action Group-run Head Start from the facts in the *Montgomery County* case and holding that the Community Action Group at issue did not qualify as an "educational institution." Appeal No. B-08-09-H-1078 (Issued April 17, 2008). The Board relied on the facts that in that case, unlike in *Montgomery County*, the employer did not wish to be considered an "educational institution" and therefore did not object to the teachers receiving unemployment compensation over the summer, and that because the employer conceded that it was a Community Action Agency, the UIPL's guidance on not classifying "Community Action Groups" as "educational institutions" would be followed.

DAB Nepotism *continued from page 7*

the section "Conflict of Interest or Nepotism" in the GAM "[prohibits] the hiring of any individual if a member of that individual's immediate family is employed in…a position having responsibilities relating to the selection, hiring, or supervising of employees"; sisters were included in the definition of immediate family.

6 *Utica Head Start Children and Families, Inc.*, DAB No. 1749 (September, 2000) holding that "Utica failed to conduct its program in a manner free of family favoritism as required by the Head Start Act, regulations and policies" because it permitted the employment of the daughter of the executive director as the fiscal director.

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include the Grant A carryover funds on the Grant B FSR. The DAB did not accept two later prepared FSRs by the grantee in attempts to correct the alleged accounting error because they were not dated, signed, or certified, whereas the first one had been. It also rejected an opinion letter by the grantee's auditor claiming the revision to be accurate, since the letter neither explained how it reached the decision nor attached supporting documentation. The DAB did not accept a position memo issued by the chief financial officer of the grantee due to the fact that it failed to discuss the erroneous accounting of the initial FSR report, but instead focused on arguing that there was no over-expenditure of federal money and "there were sufficient federal dollars remaining in the PMS [Payment Management System] to operate all federal awards." The DAB also failed to accept the grantee's argument regarding the accounting error because it was inconsistent with the original explanation of the over-expenditure given by the CFO at the time the FSR was initially submitted.

1 DAB decisions can be found online at **www.hhs.gov/dab/decisions**.

2 45 C.F.R. §1309.10 contains the requirements for purchase, construction, and major renovation of facilities with Head Start funds.

3 45 C.F.R. §74.71 spells out the steps that a grantee must follow once the budgetary period has ended, among which are submission of an expenditure report within 90 days of the end of the budgetary period and paying off the "obligations." Obligations are "amounts of orders placed, contracts and grants awarded, services received and similar transactions during a given period that require payment by the recipient during the same or a future period." 45 C.F.R. §74.2.

4 2 C.F.R. Part 230, Att. A (formerly known as OMB Circular A-122) 4 outlines the basic principles in determining whether an expenditure is allowable under a federal grant.

5 45 C.F.R. §74.21 requires grantees to have a financial management system and establishes among other things that all funds must be accounted for.