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Ignorance is Not Bliss: DAB Decisions Affirm Board Fiduciary Duties

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February 2016

In a series of decisions involving Head Start grantees and a community health center, the U.S. Department of Health and Human Services (HHS) Departmental Appeals Board (DAB) held that the boards of directors of each nonprofit grantee were ultimately responsible for the grantee's operations, even though the board was not aware of misconduct by the grantee's employees. In each decision described below, the DAB underscored the nonprofit board of directors' legal responsibilities to the organization through exercise of its "fiduciary duties." Each state nonprofit corporations act requires a nonprofit board to act as a "fiduciary" or a trustee of the organization's assets. This means that the board must exercise proper oversight of the organization's operations, including holding staff and volunteers accountable for the organization's legal and ethical responsibilities. While the board formally supervises just one employee—the Executive Director—these decisions illustrate that it remains accountable, as the leaders of the organization, for misconduct by any employee. Boards of Community Action Agencies (CAAs) are advised to ensure that employees are regularly trained in the organization's policies and that mechanisms are in place to facilitate the ongoing reporting and monitoring of potential misconduct throughout the organization.

Oversight of the Executive Director

The board is charged with exercising oversight over the Executive Director and cannot simply claim that it did not know about the Executive Director's actions that result in violations of law. In a decision[1] involving a Head Start grantee, Bright Beginnings of Kittitas County (Bright Beginnings), the DAB recognized the role of the board in preventing cost disallowances resulting from staff's failure to comply with the federal cost principles and administrative requirements governing the use of Head Start and Early Head Start funds. The DAB upheld a disallowance of Early Head Start funds that were originally allocated for operating expenses but instead, used to pay for construction costs associated with a building expansion project. Bright Beginnings' auditors found that the grantee did not request approval from the awarding agency before revising its budget to draw down Early Head Start funds intended for operating activities to pay construction costs associated with the organization's building expansion project.



Bright Beginnings did not dispute that the applicable federal cost principles[2] and the uniform administrative requirements[3] required it to obtain prior written approval to change the scope or objective of the program funds as well as to use the funds for capital expenditures. These requirements remain the same under the Uniform Guidance, 2 C.F.R. Part 200.[4] Instead, it argued that the board did not intend to violate the federal grant law requirements and did not know that employees had misused the funds. The board contended that it was neither aware of nor approved the Executive Director's decision to use the Early Head Start funds to pay for construction costs, and in fact, fired him for his conduct after learning that he had diverted the funds. The board also argued that the Executive Director had good intentions in spending the funds to complete the building project, as he wanted to ensure that the organization could continue to provide Head Start and Early Head Start services for children and families in need of such services.

The DAB rejected these arguments, reiterating the principle established in prior DAB decisions that a federal grantee's board is responsible for the actions of the employees who carry out its Head Start program. Thus, even though the board did not intend to violate federal grant law and regulations and claimed ignorance about the Executive Director's actions, the DAB held that the board bore ultimate responsibility for the diversion of funds and failed in its duties to provide for effective control over and accountability for the organization's use of federal funds. Further, the DAB held that a fundamental principle of grants management is that a grantee bears the burden of demonstrating that costs spent under federal funds are allowable and allocable. Thus, despite the Executive Director's well-intentioned desire to secure the future of Head Start services, the DAB could not waive a disallowance based on equitable principles.[5]

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Oversight of Contractor Relationships

The DAB also affirmed that a grantee's board remains the responsible fiduciary of the organization, even when the grantee subcontracts the management of its operations to another entity. In another decision,[6] the DAB found that the board of Central Alabama Comprehensive Health, Inc. (CACHI), a community health center, misappropriated HHS funds it received via a Section 330 grant from the Health Resources and Services Administration (HRSA). CACHI had entered into a contract with another party, Birmingham Health Care (BHC), to manage CACHI's financial and accounting systems, including writing checks to pay CACHI's bills and obligations. HRSA subsequently disallowed $144,611 and $40,028 from two separate HRSA awards, citing CACHI's failure to adequately document grant fund expenditures and to develop and implement procedures to ensure adequate internal control over the administration of federal funds.

CACHI did not dispute the facts that led to the disallowances Instead, CACHI argued that because it had subcontracted its financial and accounting systems management to BHC, the subcontractor was at fault and should be held responsible for the disallowances. Further, CACHI's board claimed that it did not know about BHC's embezzlement and mismanagement of funds because BHC did not report accurate



information to CACHI's board, and when CACHI finally learned of financial irregularities, it immediately terminated its relationship with BHC. Thus, CACHI argued, the DAB should order BHC, rather than CACHI, to repay the disallowed expenditures.

The DAB, however, noted that the fact that CACHI was not aware of and did not approve of BHC's management of the grant funds was irrelevant, and upheld the cost disallowances. The DAB relied on prior decisions to find that, as the federal grantee under the terms of the grant award, CACHI remained ultimately responsible for the use of the funds. In the same way that the board of a federal grantee owes a fiduciary responsibility to supervise the employees its hires (e.g., the Executive Director), the board is also responsible for overseeing the contractors it engages to manage its finances. The DAB also held that while CACHI could seek recovery of the disallowed funds from BHC in a separate proceeding, the DAB had no authority to order BHC to repay the funds.

Monitoring and Implementing Corrective Actions

A board is expected to monitor compliance with an organization's internal policies and to take corrective action when the organization is cited for failing to implement its policies. In a decision involving another Head Start grantee,[7] the DAB upheld the termination of Pinebelt Association for Community Enhancement (PACE)'s Head Start designation after the grantee failed to place a teacher accused of sexual abuse on administrative leave, as required by its policy on abuse, and failed to properly investigate the allegations. In this case, the organization did not report the abuse allegation to PACE's Executive Director until over a year later, and the teacher remained in PACE classrooms and facilities for over two years after the initial report of abuse. As part of its regular review of Head Start grantees' programs every three years,[8] ACF issued PACE a deficiency notice based upon a finding that PACE failed to take the actions required by its policies regarding child abuse and molestation[9] and gave PACE thirty days to correct the deficiency.[10] ACF subsequently conducted a follow-up review[11] and, after determining that PACE had not corrected the deficiencies, terminated PACE's funding.[12]

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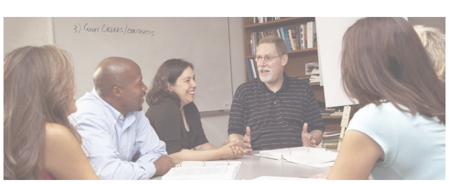
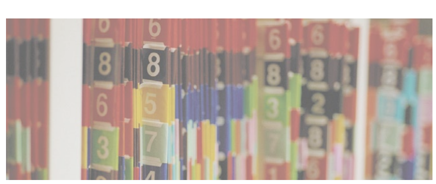
PACE's board argued that it did not act because the Executive Director did not notify the board of the abuse allegations until after ACF issued the deficiency notice, so it had no knowledge that the organization had not been complying with its abuse policies. The DAB rejected this argument, noting prior decisions that consistently held that "the responsibility for the quality of a grantee's staff rests squarely on the grantee, and that the grantee does not cease to be responsible for the actions of its staff or their consequences simply by asserting that the staff involved have been fired." As the board is responsible for its employees' actions, the fact that it did not know about PACE's failure to implement its child abuse policy does not excuse the board's failure to comply with Head Start requirements.

PACE further argued that the board took steps to correct the deficiency within the 30-day period required by ACF, noting that the board adopted a revised procedure for reporting suspected child abuse and neglect at a board meeting. The DAB dismissed this argument, noting that the actions required under both procedures were





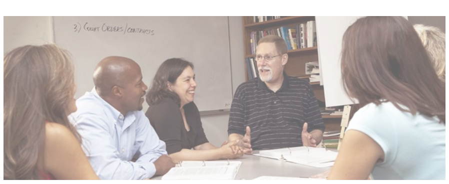
substantively similar and PACE did not explain how the new procedure differed from the previous one. Further, PACE failed to show how it would take steps to ensure that the revised policy would be implemented (e.g., training staff on what the new policy required). The DAB noted that the minutes of the board meeting during which the board discussed and adopted the new procedure did not identify any specific corrective actions that PACE implemented. Three members of the PACE board indicated they were prepared to testify to certain corrective actions the board allegedly took at a subsequent board meeting. However, since this meeting occurred nearly three months after the 30-day corrective period, the DAB found that the testimony would have been irrelevant to whether PACE corrected the deficiencies within the required time frame.

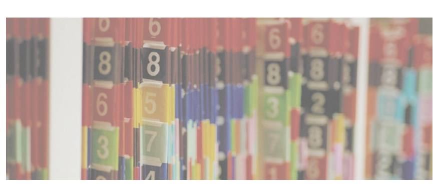
Takeaways

These decisions highlight the risk of having a board that is ignorant about how the organization spends its funds or whether the organization follows its own internal policies. Boards must strike a balance between allowing employees to manage the day-to-day operations of the organization while remaining vigilant in ensuring that proper procedures and regular reporting are in place to detect any allegations of misconduct and misuse of organizational assets. CAAs that are questioned on a particular policy or practice should be prepared to produce documentation showing that their boards took corrective action in a timely manner and in a way that addresses the underlying finding of noncompliance.

Actions a board could take include:

- The board chair conducting regular check-ins with the Executive Director, not just relying on the annual review;
- Using board committees to oversee large contractual relationships;
- Requesting regular updates from the Executive Director on the implementation of organizational policies and training of staff on the policies; and
- Establishing board committees to review and facilitate the updating of policies (e.g., a human resources committee to oversee the implementation of personnel policies).





End Notes

[1] Bright Beginnings for Kittitas County, DAB No. 2623 (2015).

[2] 2 C.F.R. Part 230 Appendix B, ¶ 15.b(1) (requiring prior approval by the awarding agency to charge capital expenditures for land or buildings, including expenditures for improvements to land or buildings which materially increase their value).

[3] 45 C.F.R. § 74.25(b) (requiring grantees to report deviations from budget and program plans and request prior approval for budget and program plan revisions).

[4] 2 C.F.R. § 200.308(b); 2 C.F.R. §200.439.

[5] See, e.g., Municipality of Santa Isabel, DAB No. 2230, at 11 (2009); Bedford Stuyvesant Restoration Corp., DAB No. 1404, at 20 (1993).

[6] Central Alabama Comprehensive Health, Inc., DAB No. 2625 (2015).

[7] Pinebelt Association for Community Enhancement, DAB No. 3622 (2014)

[8] 42 U.S.C. § 9836A(c)(1)(A).

[9] 42 U.S.C. § 9832(2)(A); 45 C.F.R. §§ 1304.22(a)(5), § 1304.52(i)(1)(iii), and § 1304.52(i)(1)(iv) (requiring that Head Start grantees (1) implement policies and procedures for handling cases of suspected or known child abuse, (2) ensure that no child will be left alone or unsupervised, and (3) ensure that staff not engage in corporal punishment or physical abuse).

[10] 42 U.S.C. § 9836A(e)(1)(B)(i) (allowing the Secretary to require a Head Start grantee to correct a deficiency immediately, if the Secretary finds that the deficiency threatens the health or safety of staff or program participants or poses a threat to the integrity of federal funds).

[11] 42 U.S.C. § 9836A(c)(1)(A).

[12] 45 C.F.R. § 1303.14(b)(4) (authorizing ACF to terminate Head Start funding for failure to timely correct one or more deficiencies).