



Employee Recognition Luncheon Costs Disallowed

Ohio Department of Job and Family Services, DAB No. 1961 (February 1, 2005)

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The DAB upheld ACF's disallowance of a claim by the Ohio Department of Job and Family Services (ODJFS) to use grant funds to pay for an employee recognition luncheon. ODJFS received grant funds to support child support enforcement programs. The DAB rejected ODJFS's claim that the costs, which totaled \$1,564, were allowable as "employee morale" costs, instead holding that they were unallowable "entertainment" costs.

The questioned costs were incurred for food and other items for a luncheon held by a local child support enforcement agency to recognize certain employees for length of service, perfect work attendance, or educational achievement. Both agency employees and local community officials attended. State auditors found the luncheon costs to be unallowable under Office of Management and Budget (OMB) Circular A-87 (the cost principles for state and local governments), which was applicable to the grant in question under 45 C.F.R. 74.27(a) and 45 C.F.R. 304.10.

In its ruling, the DAB relied on OMB Circular A-87. Attachment B of the circular sets forth numbered paragraphs discussing the allowability of specific types of costs. Paragraph 18 provides:

Entertainment. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

Paragraph 17 provides:

Employee morale, health, and welfare costs. The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employee counseling services, employee information publications, and any related expenses incurred in accordance with a governmental unit's policy are allowable. Income generated from any of these activities will be offset against expenses.

The DAB also relied on two previous DAB decisions. In *Mid-America Health Systems Agency*, the DAB held that meal expenses were subject to strict scrutiny in view of the cost principles' prohibition on paying for entertainment costs.¹ That case also held that "meals not taken in connection with travel are presumed to be a personal expense unless the business transacted is documented."² And in *Humanics Associates*, the Board similarly strictly scrutinized meal costs and ultimately denied reimbursement of costs of a nonprofit grantee for food and drink consumed by employees on a business trip, including

costs incurred at a wedding party at Howard Johnson's, a liquor store, and Walt Disney World.³ In that decision, the DAB found that the grantee had not established that they were necessary and reasonable for business purposes and rejected the grantee's unsubstantiated claim that these were legitimate "employee morale costs." Although ODJFS argued that the luncheon costs were not unallowable entertainment costs because the luncheon was not designed to "amuse" employees, DAB held that the entertainment prohibition was not limited to amusement. Rather, the DAB held, the key issue was whether there was a documented business purpose. ODJFS then argued that recognizing exemplary employee service was a legitimate business purpose and that such costs were allowable as "employee morale" costs under Paragraph 17. The DAB again rejected ODJFS's argument, this time holding that this type of "employee morale" was not one of the listed components of allowable expenses under Paragraph 17. The DAB found that the luncheon costs were not of the same nature as the listed benefits because they did not directly improve employee mental or physical health or disseminate employment-related information.

Nor did the DAB agree with ODJFS that serving a meal was an integral part of recognizing employees. Since the recognition ceremony and accompanying speeches preceded the luncheon, no business was conducted at the actual meal, and the large number of attendees, including many not employed in the grant-funded program, the DAB concluded that the meal was social activity rather than a necessary cost to improve employee morale.

Although this decision certainly affects the ability of grantees to charge employee recognition food costs to grants, some important distinctions should be noted. First, since ODFJS was a state agency, the relevant cost principle circular was A-87, rather than A-122, which applies to non-profit grantees. The language of the "employee morale" provision in A-122 is broader than in A-87. The A-122 provision states:

13. Employee morale, health, and welfare costs and credits. The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable...

As compared to the A-87 provision, the A-122 provision, which includes the term "and other expenses," is clearly not limited to just the listed examples. In addition, Circular A-122, unlike A-87, lists a number of allowable purposes, such as the improvement of working conditions and employee performance. Therefore, a cost related to an employee recognition luncheon might be allowable for a non-profit grantee, although not for a state or local grantee.

Second, a decision of this type is always fact specific. The DAB seemed to focus on the fact that the business purpose of the event, such as the speeches and award ceremony, all preceded the luncheon itself and on the fact that many non-employees attended. A different decision might have been reached if the speeches and ceremony were integrated into the luncheon itself and only employees were invited. The key is establishing a legitimate business purpose for the expense.

¹ DAB No. 420, at 11 (1983).

² *Id.*

³ DAB No. 860 (1987).