

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Central New York Health Systems
Agency, Inc.
Docket No. 80-148
Decision No. 239

DATE: December 16, 1981

DECISION

Central New York Health Systems Agency, Inc. (Grantee) appealed a decision of the Public Health Service (PHS) Grant Appeals Board, disallowing a portion of a \$6,250 charge to Grant No. 02-P-000124-04. The cost disallowed represents part of an annuity paid to Grantee's Interim Executive Director. For reasons discussed below, we reverse the disallowance.

This decision is based on Grantee's Application for Review, the PHS response, relevant documents submitted by both parties, our Order to Show Cause issued September 9, 1981 and the parties' response to that Order. Grantee's response to the Order included a request for an evidentiary hearing on the issue of reasonableness. Since, as we discuss more fully below, Grantee has persuasively demonstrated the reasonableness of the annuity, we have determined that a hearing is unnecessary.

Background

Grantee is a Health Systems Agency (HSA) founded in 1976 pursuant to P.L. 93-641 and funded under 42 CFR Part 51, Subpart B. When Grantee's original Executive Director resigned, Grantee appointed its former President as Interim Executive Director for a six month period at a salary of \$25,000 plus an annuity equal to 25% of that figure (or \$6,250). The PHS Regional Office (Region II) was notified of the appointment, but was not informed of the specific terms of employment.

Region II issued a notice of disallowance on May 7, 1980, which stated the following:

[I]t has been our responsibility to insure uniform application of fringe benefits to all employees within an agency. In addition we also consider reasonableness of cost, a basic concept in the Cost Principles of 45 CFR Part 74. In this circumstance, a retirement annuity of 25% of salary is considered unreasonable and not uniformly applied within the HSA.

Grantee was directed to make the appropriate adjustments to bring the annuity in line with that given to other employees, 11.2% of salary. Grantee appealed to PHS, arguing that the annuity was reasonable, because while the controlling regulation required an equal award of benefits to employees in similar positions, the position of Executive Director was unique, so there was no basis for comparison between his annuity and that of other employees. Grantee further noted that the Interim Director had enjoyed a high annuity in his previous position (Department Head, S.U.N.Y./Morrisville) and his professional life would likely be disrupted by the transition in jobs. Grantee argued that its need for capable interim leadership, and consideration for the sacrifice the Interim Director was making in accepting the position, justified the annuity. Grantee also asserted that the applicable regulations did not require prior approval from Region II in order to provide the annuity.

PHS upheld the disallowance, noting that its Grants Policy Statement allowed the employer's share of an annuity to be charged as a direct cost to a grant only to the extent such payment was made under formally established and consistently applied institutional policies (PHS Grants Policy Statement, 1976, p. 19; PHS Decision, p. 3). PHS observed that Grantee had no policy which provided a higher annuity for temporary employees. PHS recognized the fact that Grantee claimed it had been paying the 25% annuity to its former Executive Director since 1977, but asserted that there was no evidence of such a rate in corresponding grant applications, which referred only to an annuity rate of 11.2%. Ultimately, PHS found that the general direction of the conditions of the grant, combined with a reasonable interpretation of PHS policy and regulations, should have been interpreted by Grantee as requiring, at a minimum, notification of Region II. Grantee having failed in this regard, PHS disallowed that portion of the annuity which exceeded 11.2% of the Interim Executive Director's salary.

Grantee appealed to this Board, contending that Region II was on notice as to the appointment of the Interim Executive Director and was bound by the consequences of such notice. Grantee also claimed that the 25% annuity was reasonable based upon the cost principles outlined in 45 CFR Part 74, Appendix F.

Discussion

I. Cost Principles

The Grantee's authority to charge the costs of an annuity to its grant is governed by various cost principles applicable to nonprofit institutions. As noted above, PHS based its disallowance, in part, upon a provision in its own Policy Statement. This provision merely

states that fringe benefits are allowable "to the extent that such payments are made under formally established and consistently applied institutional policies." The cost principle at 45 CFR Part 74, Appendix F, G.6(g)(5) more broadly states:

Costs of fringe benefits . . . are allowable to the extent required by law, employer-employee agreement, or an established policy of the institution.

PHS does not deny that the Part 74 cost principle applies, or that the annuity at issue was provided pursuant to an employer-employee agreement. Thus, the annuity here is an allowable type of fringe benefit under an applicable cost principle.

A general requirement of reasonableness also applies to costs claimed by nonprofit institutions. A cost is reasonable if:

[I]n its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of a competitive business.
(45 CFR Part 74, Appendix F, B.3)

Other requirements closely related to reasonableness apply to compensation costs. These costs are allowable if:

- (1) Compensation is paid in accordance with policy, programs, and procedures that effectively relate individual compensation to the individual's contribution to the grant or contract work, result in internally consistent treatment of employees in like situations (45 CFR Part 74, Appendix F, G.6(b))

In our Order to Show Cause we indicated that the annuity here may not be consistent with the guidelines of Section G.6(b)(1) of Appendix F. For purposes of our preliminary analysis we measured the reasonableness of the annuity in light of the Interim Director's overall compensation package. In its response to the Order, Grantee argued that the focus of our attention should have been a comparison of the Interim Director's compensation with that of his predecessor.

The Original Executive Director received a \$46,000 annual salary. The salary of the Interim Director was \$25,000 for six months. PHS conceded that the temporary nature of the position may have justified the higher salary and it was, in fact, approved by Region II (Decision, p. 4). Both men received the same annuity, 25% of their salary. Grantee's primary concern upon the resignation of the original

Director was to find a person of the same caliber, capable of maintaining the momentum which the original Director had initiated. It argued that the pressure it felt was compounded in part by the relatively short notice (one month) it had received, as well as the less than uniform demographic area which it served (Grantee's response to the Order (Brief), §A). Grantee thought it necessary to seek a replacement from outside its organization as a safeguard against internal dissension and program disturbance. In order to attract qualified applicants to a temporary position, Grantee decided to offer a compensation package approximating that of its Original Director (Brief, §B).

In the Order to Show Cause we indicated to PHS that the disallowance might be reversed if Grantee could produce evidence sufficient to convince us that the annuity was reasonable (Order, pp. 7-8). PHS questioned the reasonableness of the annuity, yet, in presenting its position to the Board, largely made conclusory references to the concept of reasonableness of cost. Region II stated in its disallowance letter simply that: "We [Region II] consider reasonableness of cost, a basic concept of the Cost Principles of 45 CFR Part 74, Appendix F."

PHS apparently accepted the judgment of Region II on its face, for in its decision it stated that "the Regional Office correctly applied the test of reasonableness to the annuity in question." In its initial response to this appeal, PHS supplied the Board with a memorandum from Region II which attempted to explain its application of reasonableness to the facts in issue. The position outlined in the memorandum compared the reasonableness of the annuity which the Interim Executive Director was to receive to that which he received in his position at Morrisville. Grantee contends that the reasonableness of the annuity should be measured in the context of the position the Interim Director was filling, rather than that which he was leaving.

We find Grantee's argument and evidence on this issue convincing. Grantee's decision to offer a 25% annuity resulted from careful consideration of a number of pertinent factors. Further, although PHS has questioned the reasonableness of the annuity, it has not sufficiently developed its position on this issue to support the conclusion that the annuity was unreasonable. Accordingly, we find the Interim Director's annuity to be reasonable in amount.

II. Prior Approval

In its response to Grantee's appeal, PHS argued extensively that the annuity package required prior agency approval as it was in excess of the annuity rate specified for all employees in the grant award. PHS supported its position by citing various sections of its own

Policy Statement and Grants Administration Manual which, it claimed, mandated prior approval in this instance.

The more comprehensive PHS Policy Statement provides:

Documentation of the approved budget on the Notice of Grant Award constitutes prior approval for the performance of activities and the expenditure of funds for specific purposes and items described in the grant application unless otherwise restricted by the Notice of Grant Award. (pp. 4-5)

PHS also relies on 45 CFR §74.176, which contains a comparable provision.

We conclude that prior approval is not required in this instance. Our conclusion is based on the PHS Grant Appeals Board Decision (p. 4), which stated that prior approval was not specifically required by the conditions of the grant award, and on the fact that neither Part 74 nor the PHS Policy Statement establish a requirement of prior approval for fringe benefits. Further, the policies relied on by PHS do not require prior approval for any specific cost item but merely describe what constitutes prior approval, where that approval is required by applicable cost principles.

Conclusion

For the reasons stated above, we reverse the disallowance. Grantee may charge the full cost of the annuity (\$6,250) to Grant No. 02-P-000124-04.

/s/ Cecilia Sparks Ford

/s/ Norval D. (John) Settle

/s/ Donald F. Garrett, Panel Chair