

**Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division**

Norwalk Economic Opportunity Now, Inc.
Docket No. A-12-65
Decision No. 2543
November 19, 2013

DECISION

Norwalk Economic Opportunity Now, Inc. (NEON) appealed the March 26, 2013 determination of the Administration for Children and Families (ACF) disallowing federal funds totaling \$408,434. Based on an audit by the Department of Health and Human Services (HHS) Office of the Inspector General (OIG), ACF found that NEON charged \$383,312 in unallowable expenditures to its Head Start grant and \$23,122 in unallowable expenditures to American Recovery and Reinvestment Act (ARRA) funds ACF awarded for Head Start quality improvement activities. On appeal, NEON contests \$317,583 of the Head Start disallowance and \$10,598 of the ARRA disallowance.

For the reasons discussed below, we uphold the disallowances in full.

Legal Background

Head Start is a national program administered by ACF that provides comprehensive health, educational, nutritional, social, and other services primarily to low-income children, ages three to five, and their families. 42 U.S.C. § 9831; 57 Fed. Reg. 46,718 (Oct. 9, 1992). ARRA provided additional funding for the Head Start program. Public Law No. 111-5, Tit. VII (2009). ACF awarded ARRA funds to Head Start grantees for purposes including quality improvement activities and instructed grantees that use of quality improvement funds “must be consistent with the provisions of Section 640(a)(5) of the Head Start Act.” Head Start Program Instruction 09-06, May 12, 2009 (ACF Ex. 7, at 2). Section 640(a)(4)(C) of the Head Start Act requires that certain funds appropriated for Head Start be used for “quality improvement activities described in paragraph (5).” These activities include “improv[ing] the compensation (including benefits) of educational personnel, family service workers, and child counselors . . . to . . . (iii) provide educational and professional development” Section 640(a)(5)(A).

Head Start grantees must comply with regulations specific to the Head Start program and with regulations at 45 C.F.R. Part 74 that apply to all HHS grants to non-profit organizations. 45 C.F.R. § 1301.10(a). The Part 74 regulations, in turn, incorporate the principles in Office of Management and Budget (OMB) Circular A-122 (now codified at

2 C.F.R. Part 230) for determining allowable costs under awards to non-profit organizations such as NEON. 45 C.F.R § 74.27(a). Under the cost principles, to be “allowable” under an award, costs must be, among other things, reasonable for the performance of the award, allocable to the award, and adequately documented. 2 C.F.R. Part 230, App. A, ¶ A.2.a, g. A recipient of federal funds must have in place a financial management system that provides “[r]ecords that identify adequately the source and application” of funds for grant activities, as well as “[a]ccounting records, including cost accounting records, that are supported by source documentation.” 45 C.F.R. § 74.21(b)(2), (7).

The Board has consistently held that, “under the applicable regulations and cost principles, a grantee bears the burden of documenting the existence and allowability of its expenditures of federal funds.” *Suitland Family & Life Dev. Corp.*, DAB No. 2326, at 2 (2010), citing *Benaroya Research Inst.*, DAB No. 2197 (2008). “Once a cost is questioned as lacking documentation, the grantee bears the burden to document, with records supported by source documentation, that the costs were actually incurred and represent allowable costs, allocable to the grant.” *Northstar Youth Servs., Inc.*, DAB No. 1884, at 5 (2003).

“A cost is allocable to a particular cost objective, such as a grant . . . , in accordance with the relative benefits received.” 2 C.F.R. Part 230, App. A. ¶ A.4(a). An allocable cost may be categorized as either direct or indirect. Direct costs “can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization.” *Id.* ¶ B.1. “Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective.” *Id.* ¶ C.1. Examples of indirect costs include “salaries and expenses of executive officers, personnel administration, and accounting.” *Id.* ¶ C.2. Indirect costs are reimbursed through an indirect cost rate negotiated with and approved by the federal cognizant agency, which in NEON’s case is HHS through its Division of Cost Allocation (DCA). *See, e.g.*, January 2007 HHS Grants Policy Statement (ACF Ex. 6) at I-23; Head Start Early Childhood Learning & Knowledge Center, Training & Technical Assistance, Indirect Costs Narrative, at <http://eclkc.ohs.acf.hhs.gov/hslc/tta-system/operations/fiscal/narrative/Indirect%20Costs.htm>.

We identify other applicable regulations in the analysis below.

Case Background

NEON is a community action agency that receives federal, state, and local grants to provide programs and services to economically disadvantaged persons in several municipalities in Connecticut. In addition to Head Start, NEON’s programs include

employment services and job training, early childhood development and day care, housing, and supplementary assistance for food and energy assistance. NEON Ex. 10, 3rd page; ACF Ex. 2, at i (internal numbering).

The OIG reviewed costs claimed by NEON for the period January 1, 2009 through March 31, 2011 under its Head Start grant for the budget periods January 1-December 31, 2009, January 1-December 31, 2010, and January 1-December 31, 2011 as well as its ARRA grant for the period July 1, 2009-September 30, 2010. ACF Ex. 2, at 2 (internal numbering); ACF Exs. 5, 12. The OIG found that, although NEON had proposed in its grant application to charge “administrative compensation and expenses” directly to its Head Start grant, it used an indirect cost methodology that was not approved by DCA to allocate \$383,312 of such costs to its Head Start grant. ACF Ex. 2, at 3 (internal numbering). The OIG also found that NEON claimed \$23,122 of ARRA funds for unallowable expenses, including “\$10,598 for tuition for non-Head Start employees[.]” *Id.* at 3-4.

By letter dated March 26, 2012, ACF advised NEON that it was disallowing the costs identified above. NEON timely appealed to the Board. At the parties’ request, the Board initially stayed the proceedings for several months pending settlement negotiations.

The record for the case consists of the parties’ briefs and exhibits, including NEON’s response to an Order to Develop Record issued by the Board. NEON alleged that ACF’s response brief shows that “there are material disputes” in the case and requested “the opportunity to present testimony” at a “hearing on the merits.” NEON Reply Br. at 1-2. However, as explained below, we find that there are no “material facts in dispute the resolution of which would be significantly aided by a hearing[.]” *See* 45 C.F.R. § 16.11(a). Accordingly, we deny NEON’s request.

Analysis

I. NEON has not shown that any of the administrative salaries and expenses charged to its Head Start grant were allowable.

In 2007, NEON’s Board of Directors approved a “Cost Allocation Plan” stating that all “indirect administrative costs” would be “pooled” in one “cost center” from which costs would be distributed to “the various programs” using “a single indirect cost rate,” with “project salaries” as the distribution base. NEON Ex. 11, 2nd page. The plan further states:

Administrative costs are defined as expenses that are incurred for the overall general executive and administrative offices of the organization and other expenses of a general nature that do not relate solely to any function of the organization. They shall include allocable salaries and fringe [*sic*] of our Executive office, HR and Finance Departments

Id. ACF disallowed all of the administrative salaries and expenses NEON charged to its Head Start grant from January 1, 2009 through March 31, 2011 on the ground that NEON claimed them as indirect costs without obtaining and using an indirect cost rate approved by DCA.

NEON does not deny that it did not obtain and use an approved indirect cost rate.¹ Instead, NEON argues that, of the \$383,312 disallowed for administrative salaries and expenses, \$33,211 was never charged to its Head Start grant and \$284,372 could have been properly charged as direct costs and should therefore be allowed.² NEON Br. at 14; NEON Response to Order at 3. We discuss these two matters in turn below.

NEON failed to account for \$33,211 initially charged to its 2011 Head Start grant for administrative salaries and expenses.

NEON argues that \$33,211 of the amount ACF disallowed as administrative salaries and expenses that were improperly charged to NEON's Head Start grant was never actually allocated or charged to that grant and should not be disallowed. NEON Br. at 10-11; NEON Reply Br. at 10; NEON Response to Order at 3. NEON asserts that it initially debited \$33,211 in administrative salaries and expenses to its Head Start account during the first quarter of 2011 but later made an adjusted journal entry crediting \$33,211 to its Head Start account and debiting that amount to another, non-Head Start account. NEON

¹ NEON nevertheless asserts that ACF was aware "at all points" of the method it used to charge administrative salaries and expenses to Head Start and implies that ACF did not previously question this method. NEON Br. at 6 n.2. ACF does not deny that it was aware of the method. *See* ACF Response Br. at 24-25. However, ACF's failure to disallow administrative salaries and expenses previously charged to NEON's Head Start grant as indirect costs on the ground that NEON did not have an approved indirect cost rate does not preclude it from disallowing the costs for the period in question here on that ground. *See, e.g., Northwest Tennessee Econ. Dev. Council*, DAB No. 2200, at 7 (2008) (stating that "a federal agency's failure to disallow unallowable costs in a prior period does not preclude it from doing so later" and citing cases).

² We round the amounts in question to the nearest dollar.

Reply Br. at 10, citing NEON Exs. 15, 26; NEON Response to Order at 3, citing NEON Ex. 15.³ According to NEON, it ultimately used funds from the non-Head Start account to pay for the \$33,211 in question based on the OIG's indication that administrative salaries and expenses would be disallowed. NEON Br. at 11.

We conclude that the adjusted journal entry alone is not a sufficient basis for reversing the disallowance. That NEON moved charges in the organization's accounting records does not necessarily mean that NEON's original charge of \$33,211 to its Head Start account did not result in NEON's drawing down more federal cash than the amount to which NEON was entitled based on its allowable expenditures. As ACF notes, the adjusted journal entry shows that "\$33,211.16 went back into NEON's 2011 Head Start grant account (Account No. 2701) [on NEON's balance sheet], thereby increasing the balance of this account by \$33,211.16." ACF Sur-Reply Br. at 9. The adjusted journal entry does not show what further disposition, if any, was made of these unobligated funds. Under the applicable cost principles, NEON was required to repay to the federal government any Head Start funds drawn down for a budget period that were not used for allowable Head Start costs incurred in that budget period unless NEON was authorized by ACF to carry over the unexpended funds to the following budget period or otherwise use them for another project. *See* 45 C.F.R. § 74.71(d) (stating that a grantee "shall promptly refund any balances of unobligated cash that HHS has advanced or paid and that is not authorized to be retained by the recipient for use in other projects"). NEON does not allege that it repaid any unobligated Head Start funds for 2011 or that it was authorized to carry over any such unobligated funds to the subsequent Head Start budget period or to use them for a different project.

Moreover, there is no basis for finding that NEON expended non-federal funds for Head Start program costs that could be offset against the amount it is required to repay. NEON asserts that it "utilized non-GABI, unrestricted funds from the City of Norwalk to pay for the administrative salaries and expenses that it had initially planned on allocating to Federal Head Start." NEON Reply Br. at 10. However, NEON submitted no source documentation to support this assertion. In any event, such administrative salaries and expenses would not be allowable Head Start program costs for the reasons we discuss in the following section of this decision.

³ ACF states that NEON's general ledger reports indicate that adjusted journal entries were made in October and November of 2011 rather than in the first quarter of 2011. ACF Sur-Reply Br. at 7-8, citing NEON Ex. 15, Batch Detail Report at 1, and ACF Ex. 11, at 1. However, the date(s) on which the adjusted journal entry or entries were made is immaterial in light of our analysis below. Thus, contrary to what NEON asserts in its hearing request, there is no material dispute of fact regarding the adjusted journal entry. *See* NEON Reply Br. at 1-2.

Since NEON has not properly accounted for \$33,211 of the Head Start funds disbursed to it, we conclude that this amount was properly disallowed.

NEON failed to adequately document that any administrative salaries and expenses were allocable to its Head Start grant.

NEON asserts that \$284,372 of the \$383,312 of disallowed administrative salaries and expenses could have been properly charged as direct costs. NEON Response to Order at 3. The documentation submitted by NEON for these costs identifies ten administrative positions: CFO, Sr. Accountant, Deputy Director, HR Director, HR/ADMIN Asst., Payroll, Accts Payable, IT Administrator, IT Program and Comptroller. NEON Exs. 12A-C.⁴ As explained in detail below, the disputed costs are not allowable because NEON has not shown that it complied with the specific requirements in the cost principles for documenting employee compensation, which apply regardless of whether such compensation is treated as an indirect or direct cost.⁵

The cost principles require that “[t]he distribution of salaries and wages to awards must be supported by personnel activity reports” that: (1) “reflect an after-the-fact determination of the actual activity of each employee”; (2) “account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization”; (3) are “signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee [and indicate] that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports”; and (4) are “prepared at least monthly” and “coincide with one or more pay periods”.⁶ 2 C.F.R. Part 230, App. B, ¶ 8.m.(2). NEON did not provide any personnel activity reports for the employees in question.

Instead, for each of the three years in question, NEON provided what it called a “summary time sheet” that lists the ten positions identified above and shows, in addition to the salary for each position, an “allocation” expressed as a percent and the amount of the annual salary allocable to “Federal Head Start,” calculated by multiplying the salary

⁴ The total of the “Federal Head Start” personnel costs shown in these exhibits for the ten positions is less than \$284,372. However, we need not resolve this discrepancy in light of our conclusion that NEON failed to adequately document that any of the costs were allocable to its Head Start grant.

⁵ ACF contends that the costs are indirect costs that could be charged to federal funds only pursuant to an approved indirect cost rate. ACF Response Br. at 15. We need not reach that question in view of our conclusion that the costs would not be allowable even if charged as direct costs.

⁶ NEON does not invoke the one exception to the requirement for personnel activity reports (“when a substitute system has been approved in writing by the cognizant agency” responsible for negotiating and approving indirect cost rates, 2 C.F.R. Part 230, App. B, ¶ 8.m.(1)), and that exception clearly was not applicable here.

amount by the corresponding percent.⁷ NEON Exs. 12A-C (2nd page of each). Based on the total of purportedly allocable salary amounts for each year, another document shows the amount allocable to Head Start for “taxes” and the amount allocable to Head Start for “fringes,” as well as the percentages used to calculate these amounts for 2009 and 2010 (but not for 2011). NEON Exs. 12A-C (1st page of each). The exhibits appear to have been prepared expressly for this appeal, rather than contemporaneously, since captions on the first page of each exhibit read “Per OIG findings using Indirect Pool allocations” and “Reallocating using Direct Allocation Method.”

Even if the “summary time sheets” had been prepared contemporaneously, they do not satisfy the requirement in the cost principles for personnel activity reports because they do not specify how each individual actually spent his or her time or contain any indication of how the percentages used to calculate the costs allegedly allocable to NEON’s Head Start grant were derived. We note that the percentage for each position is the same in each of the three years, indicating that the individual in question spent the same amount of time on Head Start activities in each year. This highly calibrated consistency from year to year seems implausible on its face, at least without any supporting documentation.

NEON asserts that the salary allocations shown on these documents “are supported by sworn affidavits by the individuals whose salaries were paid using Federal Head Start funds.” NEON Br. at 15-18. However, NEON provided affidavits of only four of the individuals in question -- the Director of Human Resources, the Accounts Payable Administrator, the IT Administrator, and the Comptroller. Each affidavit states, “I often work directly on Federal Head Start related projects,” gives a few general examples of work performed in the three years in question, and concludes “I delegated [*sic*] more than [the applicable %] of my time in fiscal years 2009, 2010, and 2011 to overseeing and benefitting the Federal Head Start Program through working directly on grant-related projects.” NEON Exs. 7, 7A-C.⁸ Like the summary time sheets submitted by NEON,

⁷ The salary amounts shown for 2011 were only for the period January – March because the period covered by the audit ended in March 2011.

⁸ NEON’s brief explains that because it “has undergone a significant overhaul of its top-level management in an attempt to rectify deficiencies cited in the Disallowance ... NEON is unable to produce affidavits to support the percent allocations for the former CFO and Deputy Director.” NEON Br. at 23. NEON nevertheless asserts, without any supporting attestation, that the allocation percentage shown on the summary time sheets for the former CFO represents the percent “of his time devoted to working directly on Federal Head Start Grant-related projects[.]” *Id.* at 24. Similarly, NEON asserts that the allocation percentage shown for the former Deputy Director represents the percent of her time “overseeing and benefitting the Federal Head Start Program.” *Id.* at 25. These unsupported assertions lack any probative value.

none of these affidavits documents with the specificity required by the cost principles the nature and amount of grant-related work performed. Merely giving a few general examples of work performed during a multi-year period of time does not “account for the total activity for which employees are compensated.” 2 C.F.R. Part 230, App. B, ¶ 8.m.(2)(b) (emphasis added).

NEON points to the Board’s statement in a prior decision that “documents such as summary time sheets, which indicate the time that an employee actually worked on grant-related projects, accompanied by signed affidavits, may constitute adequate documentation for wage and salary expenditures under cost principles requiring time sheets.” NEON Br. at 19, quoting *Philadelphia Parent Child Ctr., Inc.*, DAB No. 2297, at 6 (2009). Accordingly, NEON asserts, “summary time sheets and sworn affidavits which confirm the amount of time that each employee spent benefitting the Federal Head Start Program constitute adequate documentation to support the percentage charged to the Federal Head Start Grant for administrative expenses and salaries.” *Id.*

However, nothing in the decision on which NEON relies indicates that affidavits signed by employees or their supervisors, without more, could satisfy the substantive requirement for source documents that show the time an employee actually worked on grant-related projects. Instead, the Board merely suggested that affidavits might under appropriate circumstances satisfy the requirement that the requisite personnel activity reports be signed by the employee or a supervisor having first-hand knowledge of the employee’s activity. The Board ultimately found the affidavits submitted by Philadelphia Parent Child Center insufficient because the grantee did not provide any documentation satisfying the requirement for personnel activity reports. Similarly, here NEON’s self-described “summary time sheets” do not constitute a record of the time each employee actually performed work benefitting NEON’s Head Start program. Instead, as indicated above, these documents posit an allocation percentage to be applied to each employee’s salary that is not supported by source documents showing how the percentages were derived. Indeed, the documents lack any indicia that they can be relied on to show actual time spent on Head Start activities. The signed affidavits do not cure NEON’s failure to provide even the basic information required by the cost principles.

NEON requests a hearing on what it identifies as a material dispute regarding “NEON’s allocation method,” specifically, “the percentage of time that each of NEON’s administrative employees spent working directly on Head Start grant related projects.”

NEON Reply Br. at 1-2. However, NEON does not identify any witnesses or say that any witness would testify as to anything other than what is in the affidavits, which, as discussed above, do not satisfy the documentation requirement in the cost principles.⁹

Accordingly, we conclude that the administrative salaries and expenses at issue were properly disallowed because NEON has failed to document that they were allowable as either direct or indirect costs.

II. NEON has not shown that it expended \$10,598 for costs that were properly charged to ARRA funds.

NEON disputes the disallowance of the \$10,598 of ARRA funds that ACF found was claimed as tuition for non-Head Start employees. According to NEON, the costs comprising this amount are allowable because the individuals in question were teachers or childcare staff who worked with Head Start students. NEON Reply Br. at 3-9. NEON identifies the costs as: 1) payments to Charter Oak State College and Norwalk Community College for tuition for 20 teachers and childcare staff; 2) a payment to reimburse a teacher for a single tuition payment to Charter Oak State College; 3) a payment for first aid and CPR training for childcare staff; 4) a payment for registration for 11 childcare staff in the Norwalk Early Care and Education Spring Conference; and 5) a payment for a one-year subscription to the National Association for the Education of Young Children (NAEYC) Online Portfolio Management service. NEON Br. at 26; NEON Reply Br. at 2-10.

The Board's Order to Develop Record noted that the documentation NEON submitted for these costs shows that the salaries of some individuals for whom NEON made college tuition or conference registration payments were funded by a program other than Head Start or in addition to Head Start and that the documentation does not identify any funding source in other cases. Order at 3-4. The Order also noted that NEON did not provide the names of the individuals who attended the first aid and CPR training. *Id.* at 3. The Order further noted that NEON had stated that the NAEYC accredits early childhood programs without addressing whether NEON's programs other than Head Start also benefitted from NAEYC accreditation. *Id.* at 3-4. The Order directed NEON to explain why the disputed ARRA costs are allowable in light of these observations. Similarly, ACF stated that "NEON has not shown with reliable, contemporaneous payroll records

⁹ NEON does not specifically allege that there is a dispute of fact regarding the percentage of time spent on the Head Start program by the individuals for whom training costs were claimed (discussed in the next section of this decision).

and/or timesheets that these teachers worked in the grantee's Head Start program when they used the funds, and more critically, for what percentage of time these individuals worked on Head Start matters." ACF Sur-Reply at 6.¹⁰

In response, NEON acknowledges that "several teachers and staff may not have been working exclusively with Federal Head Start students" but argues that the disputed costs are not "per se unallowable because the Federal Head Start program received a direct benefit." Reply to Order at 2. NEON also argues that even if the costs are not allowable in their entirety, "ACF cannot justify a total disallowance of those costs" because the costs "at the very least provided a proportional direct benefit [to] the Head Start program." *Id.*, citing *Home Educ. Livelihood Program, Inc.*, DAB No. 1598 (1996), and *Marie Detty Youth & Family Servs. Ctr., Inc.*, DAB No. 2024 (2006). NEON submitted no additional documentation.¹¹

NEON's arguments ignore the applicable cost principles. As noted, those principles provide that to be "allowable" under an award, a cost must be "allocable" to the award and further provide, "A cost is allocable to a particular cost objective, such as a grant . . . , in accordance with the relative benefits received." 2 C.F.R. Part 230, App. A.

¶¶ A.2.a, A.4(a) (emphasis added). Thus, if NEON's expenditures benefitted a program or programs in addition to Head Start, the expenditures are not allowable in their entirety as a charge to Head Start but must be allocated among all benefitting programs, consistent with the benefit to each program. NEON has the burden of documenting the extent to which the disputed costs benefitted programs other than Head Start. Despite multiple opportunities to do so, however, NEON submitted no documentation of the percentage of each individual's salary paid for by Head Start, nor did NEON provide any other basis for allocating the disputed costs among Head Start and other programs run by NEON.

The Board decisions NEON cites do not advance its case. In *Marie Detty Youth and Family Services Center*, the grantee submitted an exhibit that had previously been made available to but was not considered by ACF to show the extent to which the cost of office furniture was allocable to its Head Start program, and the Board remanded the case to ACF to consider the exhibit. In contrast, NEON has failed to provide any documentation whatsoever showing a basis for allocation and has not provided any justification for remanding the case to give it a further opportunity to provide such documentation to

¹⁰ ACF submitted its sur-reply the day after the Board issued its Order. The Board permitted NEON to respond to both the sur-reply and the Order at the same time.

¹¹ NEON's response does not refer to its subscription to NAEYC's portfolio management service. Assuming NEON maintains that this cost is allowable because it benefitted the Head Start program, however, we reject that argument for the reasons discussed below. We also note that NEON never explained the relationship between its NAEYC accreditation and its subscription.

ACF. Nor is the Board's decision in *Home Education Livelihood Program* relevant. The issue there was whether tuition payments were charged to the proper Head Start budget period and not, as here, whether tuition payments were allocable to programs other than Head Start.

Accordingly, we conclude that the costs charged to ARRA funds were properly disallowed because NEON failed to document the extent, if any, to which any of the costs were allocable to Head Start.

Conclusion

For the reasons explained above, we uphold the disallowances of Head Start and ARRA funds in full.

_____/s/
Judith A. Ballard

_____/s/
Leslie A. Sussan

_____/s/
Sheila Ann Hegy
Presiding Board Member