

Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Northeast Louisiana Delta      DATE: March 27, 2008  
          Community Development  
          Corporation  
          Docket No. A-07-8  
          Control No. A-06-04-76438  
          Decision No. 2165

DECISION

Northeast Louisiana Delta Community Development Corporation (NELDCDC) appealed the disallowance of \$418,850 in discretionary grant funds by the Administration for Children and Families (ACF) based on the results of an audit of two grant awards for the year ending December 31, 2002. ACF determined that NELDCDC had improperly made unapproved subawards to for-profit subsidiaries in the amount of \$234,379; had used funds in the amount of \$151,510 for other programs it operated rather than to achieve the objectives of the grants at issue; and had failed to document adequately costs in the amount of \$32,961. NELDCDC responded that the funds were all spent on programs that served low-income residents in an economically devastated area and that requiring repayment of the disallowed funds would force the dissolution of the corporation.

For the reasons explained below, we sustain the disallowance in full.

**Factual Background**

Expenditures under two grants from the ACF Office of Community Services (OCS) are at issue in the disallowance. First, NELDCDC applied for and received approval for a project under grant number 90EE0518 in the amount of \$348,000 in order to create a building supply and construction company that would create 50 jobs, mostly for low-income residents. ACF Exs. 1 and 2. Second, NELDCDC applied for and received approval for a project under grant number 90EE0605 in the amount of \$349,000 in order to create an e-commerce warehouse enterprise that would create 45 jobs, mostly for low-income residents. ACF Exs. 3 and 4.

An independent audit of NELDCDC's compliance with applicable requirements of Office of Management and Budget (OMB) Circular A-122 for the year ending December 31, 2002 was completed in 2003 and concluded that NELDCDC did not "comply with the provisions of grant agreements relative to activities allowed and allowable costs," "expended grant funds to develop and enhance other programs not included in the grant agreements and to support its operations," incurred unallowable costs, and "made subawards to two subsidiaries" when the grant budgets did not provide for subawards. ACF Ex. 5 (first page of exhibit, which is an excerpt of the audit report with page number 23). These findings resulted in the following questioned costs:

Grant Award No. 90EE0518	
Subawards to subsidiary.....	\$99,442
Grant Award No. 90EE0605	
Subawards to subsidiaries.....	134,937
Costs expended on other operations.....	151,510
Unallowable program costs.....	<u>32,961</u>
Total	\$418,850

Id. ACF concluded that the use of funds under either grant for subawards constituted a change in the scope of the original projects and required prior approval from OCS, which was neither sought nor granted. ACF Br. at 2. In addition, ACF agreed with the auditor's conclusions that funds expended under award number 90EE0605 for unrelated programs and for undocumented costs were unallowable charges to the grant. By letter dated September 20, 2006, ACF disallowed the total amount of questioned funds (Disallowance letter).

By letter dated October 19, 2006, NELDCDC timely appealed the disallowance. The record for decision also includes NELDCDC's memorandum brief (NELDCDC Br.) with Attachment A; ACF's brief in support of disallowance (ACF Br.) with ACF Exhibits 1-6; and NELDCDC's rebuttal brief (NELDCDC Rebuttal Br.) with NELDCDC Exhibits A-D.

**Applicable Law**

The Community Services Block Grant Act (CSBG) authorizes OCS to award and administer grants under the Urban and Rural Economic Development Act. 42 U.S.C. § 9921(a)(2)(A). These grants are intended to alleviate the causes of poverty in distressed

communities by creating employment and business development opportunities. Id.

The administrative requirements governing the grants are located at 45 C.F.R. Part 74. A grantee is required to "request prior approvals for budget and program plan revisions" in accordance with 45 C.F.R. § 74.25.

The allowability of charges to federal funds by nonprofit organizations such as NELDCDC is governed by OMB Circular A-122 which provides a uniform set of cost principles for determining costs of grants, contracts, and other agreements and is designed to promote efficiency and understanding between nonprofit grantees and the federal government.<sup>1</sup>

Recipients of federal grants are required to have financial management systems capable of providing "[a]ccurate, current and complete disclosure of the financial results" of all projects, including records that "identify adequately the source and application of funds for HHS-sponsored activities and accounting records "that are supported by source documentation." 45 C.F.R. § 74.21(b)(1), (2) and (7). This Board has consistently held that HHS grantees bear the burden of documenting the allowability of all questioned costs charged to federal funds. See, e.g., Action for a Better Community, DAB No. 2104 (2007); Marie Detty Youth and Family Services Center, Inc., DAB No. 2024 (2006).

## **Analysis**

### **1. ACF properly disallowed grant funds used as subawards to for-profit subsidiaries.**

ACF disallowed \$99,442 from grant award number 90EE0518 as expended for improper subawards and \$134,937 from grant award number 90EEE0605 on the same basis. ACF disallowance letter at 3; see also ACF Ex. 6. Hence, the total disputed amount relating to subawards is \$234,379.

The program announcements for the two grants expressly notified applicants that "OCS does not fund projects where the role of the applicant is primarily to serve as a conduit for funds through

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<sup>1</sup> Effective August 31, 2005, OMB A-122 was codified at 2 C.F.R. Part 230, and Attachments A and B are now referred to as "Appendix A" and "Appendix B," respectively. 70 Fed. Reg. 51,927 (Aug. 31, 2005).

the use of subawards to other organizations." 64 Fed. Reg. 45,302, 45,305 (Aug. 19, 1999); 65 Fed. Reg. 38,336, 38,339 (June 20, 2000). In neither announcement does OCS prohibit all use of subawards. It is clear, nevertheless, that any applicant proposing to make subawards should have disclosed that fact and shown the subaward was not the primary purpose of the grant request. ACF Br. at 4. At a minimum, the announcements explained that such a showing would require that the applicant "must retain a substantive role in the implementation and operation of the project for which funding is requested." 64 Fed. Reg. at 45,305; 65 Fed. Reg. at 38,338.

Both announcements also contain the following definition of "subaward:"

An award of financial assistance in the form of money, or property in lieu of money, made under an award by a recipient to an eligible sub-recipient or by a sub-recipient to a lower tier sub-recipient. The term includes financial assistance when provided by any legal agreement, even if the agreement is called a contract, but does not include procurement of goods and services nor does it include any form of assistance which is excluded from the definition of "award" in 45 C.F.R. § 74.2.

Note: Subawards do not include equity investments or loan transactions since they are promulgated under third party agreements.

64 Fed. Reg. at 45,304; 65 Fed. Reg. at 38,338.<sup>2</sup>

NELDCDC argues that its grant applications "clearly provided" that it sought funds "to create for-profit subsidiaries in the building supply, warehousing and construction industry." NELDCDC Br. at 1-2; NELDCDC Reply Br. at 1.

ACF agrees that NELDCDC did propose to create a building supply and construction company and an e-warehousing company under its two grant applications. ACF Br. at 4-5. ACF denies, however, that the grant applications or the grant awards ever contemplated the use of grant funds to make transfers to or equity investments

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<sup>2</sup> Assistance which is excluded from the cited regulatory definition of award includes technical assistance, assistance in the nature of loans, payments to individuals, and contracts under federal procurement laws. 45 C.F.R. § 74.2. None of these forms of assistance are at issue in this case.

in for-profit subsidiaries.<sup>3</sup> Id. at 5. According to ACF, NELDCDC failed to disclose in its application any intention to make sub-awards, much less make any showing that it would retain the appropriate controls.

Despite NELDCDC's general claims that its applications sufficed to notify ACF of its intentions to fund for-profit subsidiaries, NELDCDC does not point to any specific language in the grant applications that makes such a plan clear. Our review of the the material from NELDCDC's applications and grant awards in the record does not reveal any such language either.

The applications clearly do seek grant funding to support the development of warehouse and building supply businesses to provide economic development and employment in a very needy area. ACF Exs. 1 and 3. Those intentions, however, do not necessarily imply passing the grant funds on to subsidiaries. Instead, the applications include budgets specifying how the grant funds would be spent by NELDCDC. ACF Ex. 1, at 3-4; ACF Ex. 3, at 3-5. The expenditures described would clearly benefit the proposed businesses but are presented as expenditures of the nonprofit grantee, with no mention of awarding grant funds to the subsidiaries for their direct use.

The application for grant award 90EE0605 stated that funding was being sought "for only one project" identified as the e-commerce warehouse. ACF Ex. 3, at 14. The application for this grant did state that NELDCDC would make an "equity investment into a newly formed company providing warehousing services to Internet-based businesses and to companies throughout the southern and central parts of the country." Id. at 18. The proposed budget, however, specified that the equity investment of \$100,000, as well as an in-kind contribution of the building by NELDCDC, were to come from "non-federal resources." Id. at 4. Further, ACF asserted, and NELDCDC did not deny, that the use of the equity investment

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<sup>3</sup> The disallowance letter references subawards made without prior approval or even disclosure; in its briefing, however, ACF also made clear that viewing the transfers as equity investments would not make them allowable. Disallowance letter at 2; ACF Br. at 5-6 ; cf. Brownsville Community Development Corporation, DAB No. 1910 (2004). The grant announcements set out detailed requirements for third party agreements to be presented to and approved by OCS prior to any such investments. 64 Fed. Reg. at 45,303-05; 65 Fed. Reg. at 38,337-39. NELDCDC does not allege that it complied with those requirements and fails to provide any documentation that would demonstrate such compliance.

as a contribution was not approved. ACF Br. at 5; see ACF Ex. 4, at 1. The largest item in the budget approved for grant award 90EE0605 was \$196,000 in facilities costs for site preparation and renovation. ACF Ex. 4, at 1. The facility funds were to be spent only on renovation, not on purchase or construction, and NELDCDC was required to record the federal interest in the property based on the renovation financing. Id. at 1-2. Additional approved costs included \$71,630 in personnel-related costs, \$4,000 for supplies and travel, and \$77,370 in other costs (identified in the application as for business development, website maintenance, and marketing expenses for the e-commerce warehouse). ACF Ex. 3, at 5; ACF Ex. 4, at 1. Nothing in the application or award discloses that any of these expenditures would be in the form of subawards or were intended to be passed through to a subawardee.

The application for grant award 90EE0518 sought \$348,000 in federal funds for the development of Delta Building Supply. The application in the record for this grant does not include the full description of the project. ACF Ex. 1. We infer, however, that nothing in the remainder of the application would support NELDCDC's claims of having disclosed any intention to make subawards to for-profit subsidiaries, since NELDCDC did not choose to supplement ACF's exhibit with any additional material from the grant application. Grant award 90EE0518 approved the federal funds which NELDCDC sought and specified their use to pay for personnel costs of one manager (\$56,250), supplies (including inventory to be purchased for resale, totaling \$183,500), purchase of equipment (including a forklift and truck, totaling \$39,000), and additional costs for contractors, travel, and other items, for a grand total of \$348,000. ACF Ex. 2, at 1. Nothing in the application or award in the record before us discloses that any of the funds would be expended on subawards or were intended to be passed through to a subawardee.

ACF also alleges that transferring the federal funds through subawards to subsidiaries constituted a change in scope from the approved grant projects and therefore would have required prior approval. ACF Br. at 2. NELDCDC does not assert that it sought or received such approval. Certainly, we cannot find arbitrary ACF's failure to grant prior approval which the grantee never even requested. Cf. River East Economic Revitalization Corporation, DAB No. 2087, at 7 (2007), and cases cited therein.

We conclude that the amounts expended on subawards were properly disallowed.

## **2. ACF properly disallowed grant funds used for projects and**

**activities outside the scope of the grant award.**

ACF disallowed \$151,510 of the e-commerce warehouse grant number 90EE0605 on the ground that the funds were used for other programs and operations of NELDCDC rather than for the purposes set out in the grant application and approved in the award. Disallowance letter at 3; ACF Br. at 6-7; ACF Exs. 5 and 6. OMB Circular A-122 sets out the fundamental principle that costs charged to federal grants must be reasonable and necessary for the performance of the award and must be allocable thereto under the cost principles. OMB Circular A-122, App. A, A.2. A cost is allocable to a particular grant award objective, in accordance with the relative benefits received by that grant project, and may be charged as a direct cost of a particular award "if it can be identified specifically with that award as a final cost objective." Rio Bravo Ass'n, DAB No. 1161, at 9 (1990).

NELDCDC acknowledges that it never succeeded in acquiring the building from which the warehouse business was to be run and decided not to "open direct competition with the local store owner who still advised that [he] would eventually sell to us." NELDCDC Rebuttal Br. at 2. NELDCDC nevertheless purchased equipment, supplies and inventory which would have been used in the warehouse, but admits "the supplies were mostly consumed in our affordable housing program" and "[m]uch of the original equipment remains in inventory." Id. While NELDCDC asserts that it did employ low-income and otherwise disadvantaged persons and provided them with instruction "in warehousing, inventory, machine operation, and construction," NELDCDC also states that many of these persons were employed with or subcontracted by its "licensed construction company, building homes for low-income residents." Id. In fact, NELDCDC neither represents nor documents that any of the employment or instruction was provided by the e-commerce warehouse business for which the grant was made, stating instead that NELDCDC's "committed goal" is to "build or cause to be built a minimum of eight to ten homes annually," while not abandoning an "ultimate goal of opening the building supply business . . . ." Id.

However valuable the goal of building low-income modular housing through its construction company may be, NELDCDC could not permissibly decide on its own, when the purpose of a federal grant became, for whatever reason, unattainable, that the money should be used for other goals or objectives. Grantees are only permitted to use federal funds only for the allowable costs of performing the activities for which the grant was awarded. See Butler County Children's Center, Inc., DAB No. 1106 (1989). Costs are allowable only if they are allocable, i.e., are of

benefit to, the activities for which the grant was awarded. See OMB A-122, Att. A, ¶ 2.a; Delta Foundation, Inc., DAB No. 1710, at 41 (1999), aff'd 303 F.3d 551, 568-570 (5<sup>th</sup> Cir. 2002).

NELDCDC essentially contends that, when it could not acquire the building which it sought funding to renovate and could not open the business it planned to develop with the grants, it could use the federal funds and equipment purchased with them to accomplish other projects. NELDCDC does not, however, cite any authority which would allow it to reprogram federal grant funds for new purposes on its own. On the contrary, NELDCDC was required by regulation to obtain prior approval for any change in "the scope or objectives of the project or program." 45 C.F.R. § 74.25(c)(1). NELDCDC's own brief describes dramatic changes in the objectives of the project, such as changing from establishing an e-commerce warehouse to building modular housing units.

NELDCDC does not allege that it even sought, much less received, prior approval to redirect grant funds to other activities or objectives of NELDCDC or its components. NELDCDC does not produce any correspondence, reports or other documentation to establish that it even notified OCS of the programming changes.

We therefore uphold ACF's disallowance of \$151,510 in funds expended under grant number 90EE0605.

**3. NELDCDC failed to document that the remaining disallowed amounts were properly spent under the grant award.**

ACF disallowed an additional \$32,961 under grant number 90EE0605 on the basis that NELDCDC failed to provide adequate documentation of how federal funds which NELDCDC drew down in that amount were expended. Disallowance letter at 3; ACF Br. at 8. The auditors provided a list identifying the costs which they found unallowable on this basis. ACF Ex. 6, at 6-9.

As noted above, the Board has often explained that the grantee has the burden to prove, with appropriate documentation, that a cost questioned by the grantor agency is allowable under the cost principles and other relevant program requirements. In this case, NELDCDC provides no documentation whatsoever that these funds were expended for allowable costs incurred to further the grant objectives. NELDCDC does not contend that it was confused about which costs were questioned by the auditors on this basis or otherwise explain why it could not provide adequate documentation.

We therefore uphold ACF's disallowance of \$32,961 in funds expended under grant number 90EE0605.

**4. NELDCDC's other arguments are unavailing.**

NELDCDC argues that prior audits in 2001 and 2002 did not "question our investment in for-profit corporations that were wholly owned by our non-profit corporation," whereas the 2003 auditor who raised the concern was a "last minute, substitute auditor." NELDCDC Br. at 2. The failure of a prior auditor to identify the problems posed by NELDCDC transferring grant funds to its subsidiaries, whether as subawards or equity investments, without meeting the requirements set out above for such transfers may be regrettable, but cannot serve to invalidate ACF's disallowance. Ultimately, grantees retain the responsibility for complying with applicable legal requirements and the provisions of the announcement and awards under which their grants were made.

NELDCDC makes the general assertion that its funds were expended in the effort to carry out the intentions and purposes of its applications, even though it "may not have successfully created viable and sustaining building supply and modular homes businesses." NELDCDC Rebuttal Br. at 1. Further, NELDCDC contends the "basic objectives" of ACF's grant programs were accomplished in that people were employed or trained and houses were built, all of which was much needed in the devastated region. Id. at 2; NELDCDC Br. at 2-3; see generally NELDCDC Exs. A-D.

ACF pointed out, however, that NELDCDC submitted no documentation to support its assertions that the funds were in fact used for the described activities. ACF Br. at 7. NELDCDC's rebuttal included four attachments, none of which included any documentation as to how the disallowed grant funds were spent.<sup>4</sup> In any case, the grants did not give NELDCDC discretion to make any use of the funds it thought desirable to serve the general purposes of the CSBG grant program, but rather specified the programs and activities for which the funds were to be expended.

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<sup>4</sup> The attachments consist of two brochures promoting various NELDCDC programs and projects; a report on the educational needs in the Louisiana Delta parishes served by NELDCDC programs; and a news announcement on a website (<http://msdi.org/news/detail.asp?NewsID=401>) reporting how NELDCDC helped a Katrina survivor move in to a new home built by NELDCDC.

We are unable to make any findings about whether and to what extent any of the disallowed grant funds might have actually been expended in efforts to implement grant objectives, even though the ultimate goals of the two grants were admittedly not met. NELDCDC does not support its assertions with any documentation despite ample notice from ACF that the burden of presenting adequate documentation was on NELDCDC.

We therefore sustain the disallowance in full. Our decision does not, however, preclude NELDCDC from proffering documentation to ACF demonstrating that any of the disallowed funds were actually expended on permissible costs of the grants, which ACF may review in its discretion. Similarly, we do not preclude NELDCDC from requesting that ACF, in its discretion, consider whether prior approval could be granted retroactively for any of the funds disallowed based on the failure to obtain required prior approvals. NELDCDC would not, however, be entitled to any further appeal rights to the Board if ACF does not decide to exercise any such discretion.

Finally, NELDCDC further asserts that it is "not financially capable of repaying the \$418,850.00 requested by ACF without dissolving the corporation." NELDCDC Rebuttal Br. at 2. NELDCDC also expresses the hope that it might be able to bring its "original goals and objectives to fruition" if not required to repay the disallowance. Inability to pay is not a basis to overturn a disallowance that is otherwise sound in law and fact; the Board has long held that it lacks authority to offer such equitable relief as debt forgiveness in such circumstances. Harambee Child Development Council, Inc., DAB No. 1697, at 4-5 (1999).

**Conclusion**

For the reasons explained above, we uphold the disallowance in its entirety.

\_\_\_\_\_/s/\_\_\_\_\_  
Judith A. Ballard

\_\_\_\_\_/s/\_\_\_\_\_  
Constance Tobias

\_\_\_\_\_/s/\_\_\_\_\_  
Leslie A. Sussan  
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