



CAA Ordered to Clarify Head Start Match in Indirect Cost Rate Case

Council for Economic Opportunities in Greater Cleveland, DAB No. 1980 (June 20, 2005)

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In the Department of Health and Human Services' (HHS) Department of Appeals Board (DAB) decision, *Council for Economic Opportunities in Greater Cleveland*, the DAB sent a Community Action Agency's indirect cost rate case back to HHS's Division of Cost Allocation (DCA) so the Community Action Agency (CAA) could submit additional evidence. At issue was \$1.6 million that the CAA, the Council for Economic Opportunities in Greater Cleveland (CEOGC), argued should not have been included in the calculation of its indirect cost rate. Indirect costs are expenses incurred for common program objectives that cannot be readily identified with a particular program.¹ Federal grantees use indirect cost rates to charge indirect costs to their federal grants. A grantee negotiates its indirect cost rate with a federal agency (a "cognizant agency"), usually the one from which it gets the largest share of its grants.²

OMB Circular A-122, "Cost Principles for Non-Profit Organizations," provides several different acceptable ways to calculate an indirect cost rate.³ The method that CEOGC used in its indirect cost rate proposal was the "simplified allocation method," in which an organization divides its indirect costs by an "equitable distribution base." According to Circular A-122, an organization using this method may use total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or another base which results in an equitable distribution.⁴

In its proposal CEOGC used direct salaries/wages and fringe benefits as the base for calculating its indirect cost rate. However, DCA concluded that CEOGC also should have included \$1.6 million of its "in-kind expenses" in the base. A footnote to CEOGC's financial statement showed that CEOGC had \$7.4 million in "in-kind expenses" for the year, consisting of volunteer services and donated space provided to its Head Start program. CEOGC submitted information to DCA indicating that \$1.6 million of these in-kind expenses were "salaries" for its Head Start program. Based on this information, DCA concluded that CEOGC had received \$1.6 million in donated services which, according to Circular A-122, must be included in the distribution base. CEOGC disputed this conclusion, the negotiation process broke down and DCA ended up setting CEOGC's indirect cost rate for the year by including the \$1.6 million in CEOGC's distribution base. CEOGC then appealed this decision to the DAB.

CEOGC argued that the \$1.6 million was actually a direct cash outlay of state Head Start grant funds (rather than the value of donated services) and therefore should not have been included in the distribution base. To support its position, CEOGC pointed to another footnote to its financial statement,

stating that HHS had permitted CEOGC to use part of its state Head Start grant as nonfederal matching funds⁵ and CEOGC therefore had included \$1.6 million of state Head Start funds in the nonfederal in-kind expenses reported on its financial statement. Supported by a letter from its accountant, CEOGC argued that its federal Head Start program had not received any donated services and that the \$1.6 million had been reported as an in-kind expense of that program in order to show that those funds had been used to meet the nonfederal matching requirement. CEOGC also contended that the \$1.6 million had already been included in the distribution base as direct salaries/wages.

DCA responded that the \$1.6 million in "in-kind expenses" could not have been a state Head Start grant expense, since the term "in-kind" refers to donated goods and services for which CEOGC otherwise would have paid cash. Moreover, DCA argued that CEOGC had not submitted evidence that the salary expenses had been double-counted, noting that if an expense had been reported in two expense categories on the financial statement, the statement would not comport with Generally Accepted Accounting Principles (GAAP) and would misstate CEOGC's financial condition. Testimony submitted by DCA noted that a nonprofit federal grantee's costs must be determined in accordance with GAAP,⁶ that the grantee's indirect cost rate must be reconciled to its audited financial statement, and that, under GAAP, where the same expenditure is recorded more than once in a schedule of total expenditures, a note in the financial statements should say so.

The DAB concluded that CEOGC had presented evidence that called into question the factual basis for DCA's rate determination (i.e., that CEOGC had received donated services of \$1.6 million) but that also failed to demonstrate that DCA had double-counted the \$1.6 million in the distribution base. Therefore, the DAB sent the case back to DCA so that CEOGC could submit additional evidence, including amended financial statements prepared on a GAAP basis, to enable DCA to figure out whether the \$1.6 million had been included as direct salaries/wages on the financial statement and to issue a new rate determination based on the expanded record.

¹ See OMB Circular A-122, Att. A, § C ¶ 1, (codified at 2 C.F.R. Part 230, App. A, ¶ C.1).

² OMB Circular A-122, Att. A., § E, (codified at 2 C.F.R. Part 230, App. A, ¶ E).

³ See OMB Circular A-122, Att. A, § D ¶ 2, (codified at 2 C.F.R. Part 230, App. A, ¶ D.2).

⁴ OMB Circular A-122, Att. A, § D ¶ 2c. (codified at 2 C.F.R. Part 230, App. A, ¶ D.2.c.).

⁵ Head Start grantees must provide nonfederal matching funds equal to 20 percent of total federal Head Start expenses. 45 C.F.R. § 1301.20(a).

⁶ See OMB Circular A-122, Att. A, § A ¶ 2e. (codified at 2 C.F.R. Part 230, App. A, ¶ A.2.e.).