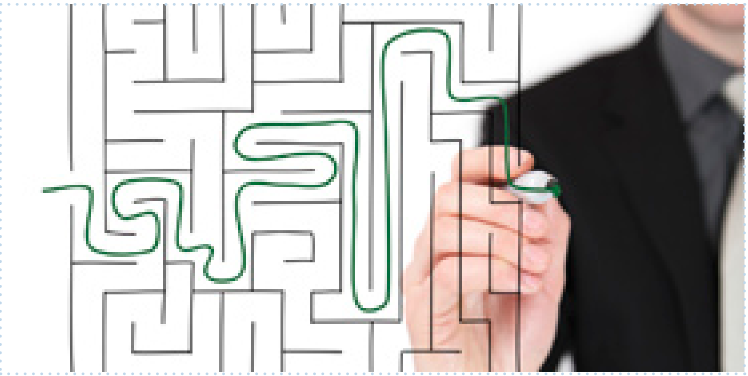

DAB Decision Focuses on Accountability and Transparency

National AIDS Education & Services for Minorities, Inc., No. 2401 (2011)

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A recent U.S. Department of Health and Human Services (HHS) Department of Appeals (DAB) decision emphasizes the importance of accountability and transparency regarding the use and management of federal funds. It underscores the fact that grant terms and conditions relating to financial and administrative matters are not mere technicalities. Failure to comply can result in serious consequences, including disallowance or termination of the full award amount.

This DAB decision, which involved a nonprofit that received funding from the Centers for Disease Control (CDC) for HIV prevention activities, focused on the grantee's failure to comply with the terms and conditions of two cooperative grant agreements. The DAB concluded that the grantee interfered with the funding source's right of access to grant-related records and employees, shifted costs from one award to another in violation of Office of Management and Budget (OMB) cost principle circular requirements, and failed to comply with financial management standards and requirements for federal grantees, as well as with prior approval requirements. According to the DAB, these failures, both individually and collectively, provided ample grounds to uphold the funding terminations.

The requirements at issue in this case were the terms and conditions of the grantee's federal awards, HHS regulations (45 C.F.R. Part 74) codifying the uniform administrative requirements for awards to nonprofit organizations (OMB Circular A-110), and the OMB cost principles for nonprofit grantees (OMB Circular A-122, 2 C.F.R. Part 230), which the HHS regulations obligate nonprofit grantees to follow. The HHS regulations impose various financial management and other standards, including requirements for situations in which prior funding source approval is required. They also authorize termination of an award if the grantee materially fails to comply with the award's terms and conditions.[1]

Key takeaways from the DAB's analysis are as follows:

Funding sources have broad rights of access to grant records and grantee personnel. Attempts to restrict this access can result in negative consequences. Therefore, it is important to be responsive to funding source requests for information and to be cooperative during site visits.

Generally, a federal awarding agency has the right to timely and unrestricted access to any books, documents, papers, or other records of recipients that are pertinent to the award. An awarding agency also has a right to timely and reasonable access to a recipient's employees for the purpose of interviews and discussions related to those documents. In this case, the funding source's right to access grant-related records was based in the HHS version of the uniform administrative requirements incorporated by reference in the terms and conditions of the organization's cooperative agreements.[2] Similar, if not identical, requirements apply to awards grantees receive directly from other federal agencies. In addition, state regulations and funding agreements generally contain similar access requirements.

The grantee in this case contended that it was only required to provide financial information to an independent auditor and not to its federal funding source, that the funding source did not have a right to access records containing information about the use of non-federal funds, and that where records contained information about federal and non-federal funds, the grantee should be permitted to redact information not related to the funding source.

The DAB found that the grantee restricted access by the funding source monitors to various business records, including bank and credit card statements, occupancy costs and back-up support for draw downs. According to the DAB, the organization also hindered monitors' access to employees by excusing staff when the monitors planned to conduct interviews and to information about employees by providing redacted personnel information. The DAB determined that the funding source needed complete information about the organization's expenditures and transactions to verify that its internal financial controls were capable of ensuring that costs were properly allocated among federal and non-federal funding sources and that federal funds were used only for purposes authorized by the cooperative agreements.

The DAB concluded that failure to provide the funding source with access to records and employees was a material failure to comply with the terms of the awards, prevented the funding source from verifying that the grantee had spent its federal funds properly and had adequate internal controls

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Non-Federal Share Decision

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Circle of Parents Did Not Specify a Valid Basis for Reversing or Modifying the Disallowance

The DAB determined that Circle of Parents failed to provide a valid basis for reversing or modifying ACF's disallowance. The Board explained that, contrary to Circle of Parents' interpretation of its communications with ACF, ACF did not indicate that it might grant a retroactive waiver. Rather, ACF advised that, if Circle of Parents failed to meet the non-federal share, ACF had the authority to reduce the federal funds previously awarded under the grant.

The DAB also restated that it is bound by the applicable regulations requiring Circle of Parents to obtain prior approval for a budget revision and authorizing ACF to disallow funds if Circle of Parents failed to comply with the terms and conditions of the award.[3] Circle of Parents had acknowledged that the federal share requirement was an express term of its award and that it had failed to seek the requisite prior approval to revise its budget.

Lastly, the DAB explained that it did not have the authority to permit Circle of Parents to use the unspent balance of federal funds from the fiscal year 2011 award to meet the matching funds shortfall for fiscal year 2009.

Lessons Learned

- Do not assume that communications with your funding source will support your organization's failure to comply with the law. If clear legal requirements exist, your organization must comply with them, unless the law permits the funding source to waive those requirements and your organization requests and obtains a written waiver.
- Following match requirements is essential even in tough economic times. Make sure your organization understands what the requirements are and, if the funding source permits waivers, how your organization may request one. For Head Start grantees, ACF recently issued Program Instruction (PI)-HS-12-02 as a reminder of the importance of complying with the Head Start Act's non-federal share requirement and of requesting a waiver if necessary.

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in place to safeguard those funds, and alone would have justified termination of the awards.

The grantee in this case appears to have been particularly uncooperative in responding to the CDC's requests for documents and information. Nevertheless, the decision still offers valuable lessons for all grantees on preparing for and responding to monitoring. Where monitors request specific documents, it is important to be responsive to their requests. Either provide the documents requested or articulate a reason for not doing so and, where possible, offer to provide the underlying information the monitors are seeking in another format. For example, if monitors request documentation of volunteer hours counted toward matching requirements, it is best to provide contemporaneous documentation, such as actual sign-in sheets that provide the name of the volunteer, the date, hours worked, volunteer activities, and the volunteer's signature. However, it may be possible instead to submit a summary compiled by staff that reports the number of hours each volunteer worked and the activities on which they worked during a specific period, with affidavits from each of the volunteers certifying that the information recorded on the summary sheets is true and accurate.[3] Remember that grantees have the burden of demonstrating that costs they charge to their federal grants are allowable.[4] Prepare for a monitoring visit by reviewing the monitoring checklist or similar tool that the monitors will be using (if available), anticipating what documents the monitors are likely to request onsite and what questions they are likely to ask, and ensuring that that those documents are readily available when the monitors arrive and that staff are prepared to answer their questions.

Costs cannot be shifted from one award to another to overcome funding deficiencies or to avoid restrictions imposed by law or by the award terms.

Under the federal cost principles for nonprofit organizations, cost shifting from one federal award to another federal award is not permitted to overcome funding deficiencies or to avoid restrictions imposed by law or by the award terms.[5]

The organization in this case had exhausted the funds available under one of its cooperative agreements and had only $95 available under the other, even though the budget or project periods for those awards were to continue for three more months. The DAB found that the organization used funds from an extension of an unrelated CDC award to reimburse costs associated with the cooperative agreements without obtaining prior approval to redirect those funds. The DAB concluded that, in so doing, the grantee violated the OMB Circular A-122 (2 C.F.R. Part 230) prohibition against shifting costs from one award to another to overcome funding deficiencies, as well as the award terms, which required prior approval from the CDC before redirecting funds. However, even if the grantee had requested prior approval to redirect the funds, it seems unlikely that the CDC would have granted that request where redirecting the funds

threatened the grantee's ability to achieve the goals of the award from which the funds were redirected.

When experiencing cash flow difficulties, a grantee may be tempted to use funds on hand from one grant to pay costs associated with another grant and to "repay" the first grant when the funds from the second grant are received. However, this is a dangerous practice that violates the federal cost principle circulars. A better approach is to obtain a revolving line of credit or to use unrestricted funds to smooth out temporary cash flow issues.

To the extent that a grantee seeks to redirect funds from one award to another for a reason other than overcoming funding deficiencies or avoiding award restrictions, the grantee should review the terms and conditions of the award to determine whether redirecting the funds is permitted, and, if so, obtain prior written approval from the funding source.

Under the federal cost principles for nonprofit organizations, cost shifting from one federal award to another federal award is not permitted to overcome funding deficiencies or to avoid restrictions imposed by law or by the award terms.

Grantees must understand and implement adequate financial management systems. Doing so is not a mere technicality, but is central to proper administration of the award.

Federal grantees are generally required to comply with some type of financial management standards. The uniform administrative requirements for nonprofits require nonprofit grantees to have financial management systems that provide for: (1) records that adequately identify the source and application for HHS-sponsored activities; (2) effective control and accountability of all funds, property and other assets to ensure that such are used solely for authorized purposes; and (3) accounting records supported by source documentation.[6] In short, federal grant recipients should be able to identify the source and application of funds for federally financed projects and to maintain effective control over and accountability of federal funds. The same is usually true of grantees receiving state funds.

If information regarding the financial management standards applicable to an award is not in the award document or in the terms and conditions that accompany the award, follow up with the funding source to obtain the applicable standards. Then ensure that your organization's financial systems are capable of complying with those standards and, if they are not, modify them as necessary to meet those standards.

[a]n award recipient must do more than show that its work is beneficial and supported by the community' in order to continue its relationship with the federal government. 'The recipient must also manage itself to ensure that taxpayer money is spent properly, in compliance with federal requirements.

The grantee in this case admitted to having "some issues" with its accounting systems, including a lack of qualified accounting personnel. The organization told the CDC that it did not keep cash receipts or disbursement journals and that its accounting system was incapable of performing reconciliations. Furthermore, the organization failed to maintain adequate funding to execute the projects associated with the awards at issue; it granted pay raises for its executive director and acting executive director without board approval; it failed to file timely, accurate or supportable payment requests after being placed on restricted payment status; and had a board of directors that did not exhibit the capacity to fulfill its role to oversee the use of financial and other organizational resources. The organization's audit report also failed to describe in meaningful detail the audit methodology or address with specificity the legal requirements at issue. The DAB found that the funding source was justified in concluding that the grantee lacked the capacity to identify the source and application of funds for its federally funded projects and to maintain effective control over and accountability of its federal funds.

Grantees should be sure they understand the circumstances in which prior approval is required and obtain it in those circumstances.

The uniform administrative requirements for nonprofits incorporated by reference in this organization's terms and conditions obligated it to obtain the awarding agency's approval for certain program and personnel changes, including a change in the project director or principal investigator or other key persons specified in the application

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or award document.[7] The organization in this case failed to obtain prior approval for the designation of the CEO and it frequently changed key program managers without notifying the awarding agency or seeking prior approval. The DAB explained that the necessity for funding source oversight was especially critical in this case because the success of the organization's programs depended heavily on the hiring and retention of qualified staff and because of unrefuted evidence of personnel practices that cast doubt on the organization's capacity to fulfill its mission (e.g., personnel records that showed that "professional boundaries were crossed, staff were demoted and/or terminated without cause, and staff were placed in technical positions…without having the technical expertise to carry out the functions of the position."

The Importance of a Grantee's Mission Does Not Excuse Legal Non-Compliance

The grantee argued that its funding should not have been terminated because organizations like it are urgently needed to prevent the spread of HIV in populations targeted by its work. The DAB rejected this argument as irrelevant observing that, "[a]n award recipient must do more than show that its work is beneficial and supported by the community in order to continue its relationship with the federal government. The recipient must also manage itself to ensure that taxpayer money is spent properly, in compliance with federal requirements."[8]

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Executive Director's Guide

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7. Help Your Board to Help You

Boards have a governing role in assessing and planning an organization's finances. In too many cases, though, executive directors expect their boards to stay high-level and strategic without equipping them for the role. It is the executive director's responsibility to provide the board with information that is appropriate to members' roles and responsibilities.

Design your financial reports thoughtfully. The board is responsible for short- and long-term planning of the organization, and its members must ensure that systems are in place for effectively using resources and guarding against misuse. The board has legal responsibility for financial integrity but board members are not the accountants, so don't inundate the board with pages of detailed accounting records and then wonder why the board can't see the "big picture." Boards need analysis and interpretation more than they need the numbers. There is no one-size-fits-all financial report. Reports must be designed to communicate information specific to the organization's size, complexity, and program structure in a format that matches the knowledge level and role of board members.

Understand how boards use financial information. The format and content of reports for the board should be determined by their intended purpose. Boards actually use financial information for four distinct purposes: compliance with financial standards, evaluation of effectiveness, planning, and immediate action.

Compliance. Most nonprofits do pretty well with providing the board with financial reports that comply with the board's legal fiduciary role to know how much the organization has received and expended. Historical financial reports, audits, and 990s are the common reports.

Evaluation. For the board to evaluate how well the organization has used financial resources, different information is needed. Comparisons are needed to measure progress toward goals, assess the financial aspect of programs, and consider financial strategies.

Planning. When the board is engaged in planning to project future needs and changes or to develop budget guidelines, they need a big-picture understanding of the organization's history and of the external environment and financial drivers.

Taking action. Sometimes the board needs to make a key financial decision to implement a strategic plan, react to a sudden change, or respond to an opportunity. In order to make a wise but timely decision, the board needs to understand the background and situation and scenarios based on one or two possible actions. And form should follow function: before developing financial reports for the board, ask what type of actions or decisions the board will need to make, and provide them with the right amount of information and analysis in a format that fits the purpose. Don't ask your board to maintain a top-level focus on strategy while submitting financial reports better suited to the auditors.

8. Manage the Right Risks

To reduce and manage risks, most nonprofits develop policies and procedures for each area of the organization. The facilities manager maintains controls over keys, access, and insurance coverage. The finance director assures appropriate segregation of duties, internal controls, and checks and balances. Program managers compile information and data to run background checks, keep licenses up to date, and maintain required reporting. If we put them all together in a binder, these policies make up the organization's risk management process.

Article End Notes

Ready, Set, Go: Preparing for the New Head Start Renewal System

1. 45 C.F.R. Part 1307.

2. 42 U.S.C. § 9832(2) (emphasis added).

DAB Decision Reinforces Importance of Meeting Non-Federal Share Requirements

3. *Circle of Parents, Decision No. 2439 (2012)*

4. For an explanation of how the a disallowance resulting from a grantee's failure to meet a non-federal share requirement was calculated by the Administration for Children and Families (ACF), see *ACF Grants Policy Note No. 11-01: Computation of Disallowances for Deficient Grantee Payment of the Non-Federal Share Requirement*

5. See 45 C.F.R. §§ 74.25, 74.62(a)(2). It is important to note that 45 C.F.R. § 74.25 requires a grant recipient to seek prior approval for budget and program revisions only in certain situations. The DAB in this decision did not offer any information regarding what actions on the part of Circle of Friends triggered the need for prior approval under 45 C.F.R. § 74.25.

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1. See 45 C.F.R. § 74.62(a)(3).

2. See 45 C.F.R. § 74.53(e).

3. See, e.g., Philadelphia Parent Child Center, DAB No. 2297 (2009)

4. See., e.g., Marie Detty Parent and Family Service Center, Inc., DAB No. 2024 (2006).

5. 2 C.F.R. Part 230, App. A ¶ 4.a.3. and 2 C.F.R. Part 225, App.

6. See 45 C.F.R. § 74.21(b)(2), (3) and (7).

7. See 45 C.F.R. § 74.25(c).

8. Renaissance III, DAB No. 2034 at 13 (2006).

An Executive Director's Guide to Financial Leadership

1. The Chronicle of Philanthropy; Money and Mission; "Shattering the Myth about Diversified Revenue," *blog entry* by Clara Miller, September 2, 2010

2. William Foster and Gail Fine [Perreault], "How Nonprofits Get Really Big," Stanford Social Innovation Review (Spring 2007): 46.

3. Jeanne Bell and Elizabeth Schaffer, Financial Leadership: Guiding Your Organization to Long-Term Success (New York: Turner Publishing / Fieldstone Alliance, 2005), 21.