



## **DAB Upholds Disallowance of Subawards and Other Unapproved Expenditures**

*Northeast Louisiana Delta Community Development Corporation, DAB No. 2165 (March 2008)<sup>1</sup>*

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HHS's Departmental Appeals Board (DAB) recently upheld the Administration for Children and Families' (ACF) disallowance of close to \$419,000 in discretionary Community Service Block Grant (CSBG) funds granted to the Northeast Louisiana Delta Community Development Corporation (NELDCDC). ACF based the disallowance on finding that NELDCDC had (1) made unapproved subawards with the grant funds; (2) used the funds to carry out unapproved programs; and (3) failed to adequately document certain expenditures made under one of the grants.

### **Background**

ACF had issued two grants to NELDCDC, referred to here as Grants A and B. Under Grant A, ACF awarded the corporation \$348,000 to develop a building supply and construction company. The project was expected to create fifty jobs, mostly for low-income individuals. NELDCDC received \$349,000 under Grant B for the purpose of starting an e-commerce warehouse enterprise. This project was also expected to create employment opportunities for low-income individuals.

In 2003, an independent audit showed that NELDCDC had failed to abide by the grant agreements' terms. First, under both Grants A and B, NELDCDC used \$234,379 for unauthorized subawards to two subsidiaries. Second, the audit uncovered NELDCDC's use of \$151,510 under Grant B for a program other than that which the Office of Community Services (OCS) had approved in the grant agreement. Third, NELDCDC failed to document \$32,961 of costs charged under Grant B.

In 2006, after reviewing the audit, ACF determined the costs were unallowable and sent NELDCDC written notice of its determination. NELDCDC appealed ACF's decision to the DAB, which considered each of the three issues as follows.

### **Subawards to For-Profit Subsidiaries**

The DAB held that the disallowance of \$234,379 was proper because NELDCDC used the funds as subawards to for-profit subsidiaries. The program announcements for Grants A and B made clear that "OCS does not fund projects where the role of the applicant is primarily to serve as a conduit for funds through the use of subawards to other organizations."<sup>2</sup> The grantee was required to seek and receive OCS's approval prior to making any subawards under its grant. Furthermore, the grantee needed to demonstrate that the subaward itself was not the primary purpose of the grant. In order for OCS to

approve a subaward, the grantee also had to show that it would retain a substantive role in the implementation and operation of the funded project.

NELDCDC argued that both grant applications made clear its plan to create for-profit companies (the building supply and construction company, as well as the warehouse). ACF responded, however, that nowhere in the proposals did NELDCDC express its intention to transfer the grant funds to those companies. The DAB agreed that NELDCDC's intention to create the companies did not itself imply that the grant funds would be surrendered to those subsidiaries for their direct use. To the contrary, the expenditures set forth in NELDCDC's budget, though designed to benefit the proposed for-profit companies, were represented as being made by the grantee itself.<sup>3</sup> Moreover, NELDCDC made no showing that it would retain a substantive role in the projects' implementation and operation.

ACF also argued that in transferring the funds to the subsidiaries, NELDCDC essentially changed the "scope" of the approved projects. A grantee must obtain approval from its funding source prior to changing the project's "scope or objectives."<sup>4</sup> Here, NELDCDC neither sought nor received such approval. The DAB agreed that because the subawards were not approved as part of the initial grant agreement, or by an amended agreement, ACF acted properly in disallowing the expenditures.

#### **Grant Funds Used for Projects Outside Award's Scope**

The DAB affirmed ACF's disallowance of \$151,510 under Grant B because NELDCDC used the funds for a program other than that approved by OCS in its award. NELDCDC was ultimately unable to acquire a building to house the e-commerce warehouse business. Instead it decided to redirect the grant funds to employing and training low-income individuals for a modular housing construction project.<sup>5</sup> NELDCDC argued that it still used the grant funds for employing and instructing low-income persons; however, none of this employment or instruction was provided by the warehouse business as specified in its grant application.

The DAB responded that a grantee may only use funds toward the purpose for which they were awarded. If the grant's original objective becomes unattainable, the grantee cannot independently decide to redirect the funds. As noted above, such a change in the project's scope requires prior authorization from the funding source. Because NELDCDC did not seek or receive this authorization, the DAB concluded that ACF was justified in disallowing the \$151,510 expended under Grant B.

#### **Undocumented Program Costs**

The DAB upheld the disallowance of \$32,961 under Grant B because NELDCDC failed to account for how these federal funds were expended. The DAB explained that when a government funding source questions certain costs, the grantee carries the burden of proving that they are allowable. To meet this burden, the grantee must furnish adequate documentation supporting its position. Here, NELDCDC failed to produce any documentation whatsoever that the expenditures were in furtherance of appropriate grant objectives. Moreover, NELDCDC did not contend that it was confused about which costs the auditor was questioning, nor did it offer any other explanation for its failure to provide the documentation.

NELDCDC offered two final arguments in its appeal. First, it argued that prior auditors had not found fault with its investment in its for-profit corporations. Therefore, the problems raised in the 2003 audit came as a surprise. The DAB responded that an auditor's error is not an excuse for the grantee's noncompliance. Instead, it is the grantee's responsibility to be aware of the terms upon which the grants were awarded and to abide by those terms.

Second, NELDCDC said that it could not possibly repay the \$418,850 in funds, as ordered by ACF, without having to dissolve the corporation. The DAB responded that financial hardship was no excuse: “Inability to pay is not a basis to overturn a disallowance that is otherwise sound in law and fact.”

The DAB noted that its decision to sustain the disallowances did not preclude NELDCDC from presenting documentation to ACF to demonstrate that the disallowed funds had been permissible expenditures under the grant. ACF could then choose to review the materials at its discretion. The DAB also observed that NELDCDC could request that ACF grant retroactive approval of the expenditures and noted that that decision that would be within ACF’s discretion and could not be appealed to the DAB.

#### **Four Lessons Learned**

A grantee can take away four lessons from the above DAB decision. First, though it is not prohibited from making subawards, the grantee must generally seek and receive the approval of the funding source prior to doing so. Second, if the funded project becomes impracticable or impossible, a grantee cannot take it upon itself to redirect the allotted funds to an alternate project, as similar as the project may be. Instead, the grantee must notify the funding source and seek prior approval to redirect the funds. Third, a grantee must keep thorough and accurate records of all expenditures made under its grant, as the burden of proving the expenditures were proper rests solely with the grantee. And finally, a grantee should familiarize itself with all the grant terms and conditions included in the grant announcement, application, and agreement and communicate with the funding source about any proposed changes.

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<sup>1</sup> DAB decisions are available at [www.hhs.gov/dab/decisions/browsedab.html](http://www.hhs.gov/dab/decisions/browsedab.html).

<sup>2</sup> 64 Fed. Reg. 45,302, 45,305 (Aug. 19, 1999); 65 Fed. Reg. 38,336, 38,339 (June 20, 2000). The program announcements defined a subaward as any sort of financial assistance, either in the form of money or property, from a recipient to a sub-recipient. 45,304 and 38,338. See also 45 C.F.R. §74.2 (defining “award”).

<sup>3</sup> The expenditures under both Grants A and B included costs for personnel, supplies, travel, and other business-related activities.

<sup>4</sup> See 45 C.F.R. § 74.25(c)(1).

<sup>5</sup> NELDCDC did purchase the supplies and equipment intended for use in the warehouse but admitted that the items were largely used as part of its affordable housing program instead.