

U.S. Department of Labor

Office of Administrative Law Judges
O'Neill Federal Building - Room 411
10 Causeway Street
Boston, MA 02222

(617) 223-9355
(617) 223-4254 (FAX)



Issue Date: 27 July 2004

CASE NO.: 1998-JTP-6

In the Matter of

COMMONWEALTH OF MASSACHUSETTS
Complainant

v.

U.S. DEPARTMENT OF LABOR
Respondent

Appearances:

Robert K. Ganong (Commonwealth of Massachusetts,
Department of Labor and Workforce Development),
Boston, Massachusetts for the Complainant

Frank P. Buckley (Charles D. Raymond, Associate Solicitor
For Employment Training Legal Services; Harry L. Sheinfeld,
Counsel for Litigation), Washington, D.C, for the Respondent

Before: Daniel F. Sutton
Administrative Law Judge

SUPPLEMENTAL DECISION AND ORDER UPON REMAND

I. Statement of the Case

This case arises under the Job Training Partnership Act of 1982, as amended, 29 U.S.C. §§1501 *et seq.* (1994) (JTPA), and is presently before the Office of Administrative Law Judges (OALJ) of the U.S. Department of Labor (USDOL) upon remand from the Administrative Review Board (ARB). The ARB vacated the decision and order issued on October 29, 2001 and remanded the case for further consideration in accordance with its opinion.

This matter involves action by the Grant Officer for the Employment and Training Administration (ETA) of the Respondent USDOL to establish misexpenditure of JTPA grant funds by the recipient, the Commonwealth of Massachusetts (the Commonwealth), and its subrecipient Service Delivery Area (SDA), the City of Lynn (Lynn SDA)¹, and to recover such

¹ The subrecipient SDA in this matter is at times referred to in documentary evidence and testimony as the Southern Essex SDA, Northshore SDA, Lynn SDA or by reference to the SDA's administrative entity, Northshore Employment Training (NET).

funds. Decision and Order of Remand at 1. Specifically, the ARB has instructed me to identify the time periods during which the JTPA operations giving rise to the questioned costs occurred and to apply the relevant statutory and regulatory provisions in effect during the respective time periods. *Id.* at 12. In addition, the ARB has instructed me to render findings concerning the question of waiver of liability, taking into account my findings concerning the JTPA requirements for recipients and subrecipients for the pertinent time periods and the statutory language concerning substantial compliance. *Id.* Furthermore, the ARB has directed me to explain the use of the term “fiscal year” or related terms and to resolve any ambiguities in the hearing testimony or documentary evidence arising from the use of “fiscal year” in the record. *Id.* Finally, I must consider the issue raised by the Grant Officer concerning the Commonwealth’s adoption of a position in this proceeding that is contrary to that taken in its own decisions disallowing costs claimed by Lynn. *Id.* at 13.

In response to the ARB’s decision and order of remand, I issued an order on July 18, 2002 advising the parties to submit briefs addressing the issues to be considered on remand and to offer any stipulations regarding the time periods addressed by specific items of evidence which are relevant to the issues to be considered. As instructed, on October 15, 2002, the parties submitted their responses including proposed stipulations.²

II. Discussion

A. Time Periods In Question

The ARB observed that the term “program year” was instituted as the time period to be used for grant funding and program planning when the JTPA was enacted in 1982 and that it continued to be an essential component of the JTPA through the years that are at issue in this case. Decision and Order of Remand at 2, n.2 (internal citations omitted). The JTPA program year runs from July 1 through June 30 and is identified by reference to the year in which the twelve-month period begins. *Id.*; 20 C.F.R. § 626.5 (1994-1997). The ARB further noted, however, that the Massachusetts fiscal year, which runs from July through June like the JTPA program year, is identified by reference to the ending year rather than the beginning year. *Id.* As a result, the use of the terms “program year” and “fiscal year” interchangeably can create ambiguity. *Id.* Consequently, the ARB instructed me to clearly identify the time periods during which the JTPA operations giving rise to the questioned costs occurred. *Id.* at 12.

In order to address this ambiguity, the parties submitted stipulations which are summarized in a table showing the disallowed costs for the calendar years in question and identifying the respective fiscal and program years. Specifically, the parties have stipulated to the time periods and disallowed costs set forth in the Table of Disallowed Costs which is attached hereto as Appendix 1. The grand total of disallowed costs equals \$9,107,986. Upon review, I conclude that the table of disallowed costs unambiguously identifies the fiscal years,

² The parties’ written responses to the Court will be hereinafter identified as follows: Grant Officer’s Brief to the Administrative Law Judge on Remand, October 15, 2002 (GO’s Supplemental Brief); the Commonwealth of Massachusetts’ Memorandum of Law, October 15, 2002 (Commonwealth’s Supplemental Brief); Brief of the Grant Officer, January 5, 2001 (GO’s Post-hearing Brief); and the Commonwealth of Massachusetts’ Post-hearing Memorandum of Law, January 5, 2001 (Commonwealth’s Post-Hearing Brief).

program years, and costs in question, and I hereby adopt the parties' stipulations. 29 C.F.R. § 18.51 (2003). Accordingly, the disallowed costs at issue in this proceeding relate to the Commonwealth's fiscal years 1993 through 1996, which correspond to the JTPA program years 1992 through 1995.

In addition to identifying the applicable time periods for the disallowed costs, the ARB directed clarification of the time periods covered by the Grant Officer's Determinations. Decision and Order of Remand at 12. In response, the Grant Officer noted in his brief that "[t]he May 13, 1998, Grant Officer's Final Determination references Audit Report No. 02-97-215-50-598, which was procured by the Commonwealth pursuant to OMB Circular A-128, and covered the Commonwealth's 1996 Fiscal Year, July 1, 1995 through June 30, 1996." GO's Supplemental Brief at 2, citing GX 1 at 11, 35-54.³ The Grant Officer further states that the amount of costs disallowed by the Grant Officer is the same amount disallowed by the Commonwealth against the City of Lynn relating to JTPA program misexpenditures with the exception of \$52,222 in Americorps program funds which are not administered by the USDOL. GO's Supplemental Brief at 12. The Grant Officer acknowledges that references to "FY" in the Final Determination refer to the Commonwealth's fiscal year. *Id.* Moreover, the Grant Officer asserts that the same is true for references in the Grant Officer's November 8, 1999 Revised Final Determination. *Id.* The Revised Final Determination contained the Grant Officer's decision with respect to the documentation offered by the Commonwealth to reduce the amount of disallowed costs, and the Grant Officer used the same time period designations appearing on the documents furnished to him by the Commonwealth. *Id.* at 3. Furthermore, the Commonwealth's determination issued to the City of Lynn which contained questioned and disallowed costs also refers to fiscal year periods. *Id.* The Grant Officer treated these references as pertaining to the Commonwealth's fiscal year. *Id.* This representation has not been challenged by the Commonwealth. In addition, the Grant Officer has referred to certain disallowed costs in the amount of \$202,397 (Title IIA: \$88,447; Title IIB: \$113,950) as "program year 1994" and "fiscal year 1994" costs. *See, e.g.*, GX 2 at 16; GX 1 at 27; GO's Post-hearing Brief at 29. Noting that these particular figures are plainly identified as Title IIA and Title IIB costs for fiscal year 1994 in the stipulated table of disallowed costs, I conclude that any references to these costs as program year 1994 appearing in the documentary evidence or written submissions of the parties are in error, and I will treat all such references to these costs as fiscal year 1994 costs.

As the ARB pointed out, the JTPA "program year" was instituted as the time period to be used for grant funding and program planning, it continued to be an essential component of the JTPA up through the years at issue, and a Grant Officer's audit determinations are typically rendered in terms of costs incurred by the recipient during particular program years which in turn determine the applicable substantive regulatory and statutory provisions. Decision and Order of Remand at 2, n.2. Despite this, the Grant Officer admits in the present case that he refers specifically to the Commonwealth's fiscal year in the Final Determination and the Revised Final Determination, not to the JTPA program year. To avoid any further confusion about the appropriate term and the corresponding time period, I will refer to the Commonwealth's fiscal

³ Documentary evidence in the record is identified as "CX" for exhibits offered by the Complainant Commonwealth of Massachusetts, "GX" for exhibits offered by the Respondent U.S. Department of Labor, and "ALJX" for exhibits introduced by the Administrative Law Judge. References to the hearing transcript will be designated as "TR."

year or identify the specific dates for the time periods discussed in this decision and order, unless otherwise noted. Accordingly, I conclude that the Commonwealth's fiscal years 1993 through 1996 (July 1, 1992 through June 30, 1996) are the applicable time periods in question, and the corresponding regulatory and statutory provisions in effect at the time will be applied.

B. Relevant Statutes and Regulations

(1) JTPA

The ARB observed that in determining that the Grant Officer had made a *prima facie* case, I relied upon Section 164(a)(2) of the JTPA, 15 U.S.C. § 1574(a)(2) (1988), which required the Commonwealth to conduct biennial independent financial and compliance audits for each recipient under subchapters II and III of the JTPA. Decision and Order of Remand at 7. However, as the ARB noted, Section 142 of the Job Training Reform Amendments of 1992, Pub.L.No. 102-367 (Sept. 7, 1992), 106 Stat. 1021, 1046, superseded the audit requirements of Section 164(a) with provisions that require, *inter alia*, each state to establish fiscal control procedures to properly disburse and account for JTPA funds in accordance with generally accepted accounting principles (GAAP) applicable in the State, the Secretary to promulgate regulations establishing uniform cost principles, and each Governor to establish procurement standards to ensure fiscal accountability and to prevent fraud and abuse under the program. Decision and Order of Remand at 7, citing 15 U.S.C. § 1574(a) (1994). The 1992 amendments to the JTPA became effective July 1, 1993. *Id.*

In addition, as I explained in my decision and order, and the ARB agreed, the recordkeeping requirements imposed by Section 165 of the JTPA must be applied along with the fiscal controls imposed by Section 164 when determining the financial management standards set by the JTPA. Decision and Order at 18; Decision and Order of Remand at 7. In particular, Section 165(a)(1) requires that recipients keep records that are sufficient to permit the tracing of funds to a level of expenditure adequate to insure that the funds have not been spent unlawfully. 15 U.S.C. § 1575(a)(1) (1994).⁴

Furthermore, the regulations implementing the JTPA were amended and interim final regulations implementing the 1992 JTPA amendments were in effect from July 1, 1993, until the final regulations took effect on June 30, 1995. Decision and Order of Remand at 7, citing 59 Fed. Reg. 45760, 45815 (Sept. 2, 1994) and 58 Fed. Reg. 31471 (June 3, 1993). Therefore, both the interim final regulations and the final regulations apply to the time periods in question. *See* 57 Fed. Reg. 62004 (December 29, 1992); 20 C.F.R. Part 627 (1993); 59 Fed. Reg. 45760 (September 2, 1994); 20 C.F.R. Part 627 (1995).

Section 164(a) of the JTPA requires that all financial transactions be conducted and records maintained in accordance with generally accepted accounting principles in each State. 57 Fed. Reg. at 62012. Specifically, Sections 164(a)(1) and 165(f)(1) of the JTPA require application of GAAP in the accounting and reporting of JTPA costs. *Id.* at 62013. GAAP are accounting rules and procedures established by authoritative bodies or conventions that have evolved through custom or common usage. *Id.* at 62012. The application of GAAP results in

⁴ I note that the language of Section 1575(a)(1) was not changed due to the 1992 JTPA Amendments.

uniform standards and guidelines for financial accounting and reporting. *Id.* In promulgating the regulations to reflect the JTPA Amendments, the USDOL did not view the inclusion of the GAAP requirement as a new requirement for most of the entities that have previously administered JTPA or other Federal grant programs. *Id.* Moreover, the audit requirements that had previously been applicable to JTPA funds, and *continued to be applicable*, required, as specified in the “Standards for Audit of Governmental Organizations, Programs, Activities, and Functions” (GAO Yellowbook), a determination of “whether the financial statements of an audited entity present fairly the financial position and the results of financial operations in accordance with generally accepted accounting principles” as part of the audit scope. *Id.* (emphasis added).

The USDOL intended “for the direction and focus of the JTPA training and employment programs to be on . . . strengthening fiscal and program accountability[.]” 57 Fed. Reg. 62004. For example, in the interim final regulations Section 627.425(a)(2)⁵ was added to clearly specify the right of a higher tier organization to monitor the financial management systems of an entity awarded a JTPA grant, subgrant or contract, and this right extended to USDOL monitoring activities. *Id.* Section 627.425(b) was revised to reflect the statutory GAAP provision and was further revised to clarify that responsibility for the adequacy of financial management systems of JTPA subrecipients is the responsibility of each subrecipient as well as the responsibility of the State. *Id.* This section further specified that JTPA-related funds must be traceable in the recipient’s or subrecipient’s financial system. *Id.* In addition, Section 627.435(a) was revised to require that costs to be charged to the JTPA program be consistent with GAAP rather than the previous consistency standard of “like circumstances in nonfederally sponsored activities.” *Id.* at 62013. Paragraphs (a) through (h) of Section 627.435 establish JTPA cost principles and provide guidance on the allowability of certain items of cost. *Id.*

Section 108 of the JTPA required that funds expended under the JTPA be charged to the appropriate cost category. 57 Fed. Reg. at 62013. Section 627.440 (a) of the regulations required costs to be charged to the benefiting cost category (or objective) to the extent that benefits are received by such cost category or objective. *Id.* Provisions covering JTPA administrative costs pools were moved from the cost limitation section to Section 627.440(f) as it is principally a cost classification subject, rather than a cost limitation subject. *Id.* The language was changed to state that, for JTPA reporting purposes, costs must be allocated to the benefiting programs based on benefits received by each program. *Id.* at 62013-62014.

Section 165(e) of the JTPA required each Governor to ensure that requirements are established for retention of all records pertinent to all grants awarded, as well as all contracts and agreements entered into under the JTPA, for two years following the date on which the annual expenditure report containing the final expenditures charged to a program year’s allotment is submitted to the Secretary. 57 Fed. Reg. at 62015. The USDOL further intended that there be expanded oversight and monitoring activities to ensure the requirements of the amendments and the regulations are accomplished. 57 Fed. Reg. at 62016. As a result, each administrative level was expected to take a greater measure of accountability for program operations through appropriate follow-up action. *Id.* For example, Section 627.475 provides that the Governor is responsible for oversight of all SDA activities and must develop a monitoring plan which

⁵ Section 627.425 is a redesignation of Section 629.35 in the prior regulations. See 57 Fed. Reg. 62004, 62012.

specifies the mechanism which, *inter alia*, regularly examines expenditures against the cost categories and cost limitations specified in the Act and the regulations, ensures that SDAs are monitored onsite at least annually, and provides for corrective action to be imposed if the provisions of the regulation are not met. 20 C.F.R. § 627.475 (1993).

A few minor changes were also incorporated into the final regulations which relate to the financial management standards affecting the GAAP requirements and to the oversight and monitoring of JTPA programs as discussed. For example, language was added to Section 627.425(b) to provide for the applicability of GAAP in each state. 59 Fed. Reg. 45760, 45781 (Sept. 2, 1994). The USDOL's intent in adding this language to this section and to Section 627.435(a) was to allow the Governor to determine which specific versions of GAAP are to be used in each State and by which entities, should this be an issue in any State, but it was not intended to give the Governor authority to waive GAAP provisions since the JTPA requires the use of GAAP. *Id.* Furthermore, although the USDOL had chosen not to completely adopt the Office of Management and Budget (OMB) Circulars, the generic cost principles in Section 627.435 are intended to be substantially the same as the provisions of Attachment A of the OMB Circulars that contain cost principles and should generally be interpreted the same as the Circulars. *Id.* at 45782. Moreover, the USDOL provided states with flexibility in designing the nature and extent of their monitoring programs while assuring that monitoring is thorough. *Id.* at 45788. Section 627.475(b)(5) was also revised to indicate that all aspects of the SDA program must be reviewed annually, although the degree of emphasis placed upon the review of each area of a program may vary from year to year. *Id.*

(2) Single Audit Act/ OMB Circular No. A-128

Although the 1992 JTPA Amendments did not reference the biennial audit requirement of the previous version, a similar requirement exists in the Single Audit Act, 31 U.S.C. §§ 7501-7507 (1994) (SAA). The regulations at 20 C.F.R. § 629.1(b) (1992) state that all programs operated under titles I, II, III, and IV of the JTPA are subject to the provisions of 29 C.F.R. Part 96, which implement the SAA. In addition, the requirements of 20 C.F.R. Part 96, which also implement OMB Circular No. A-128, apply to JTPA recipients and subrecipients and must be followed for audits of "all program years beginning after July 1, 1985." 20 C.F.R. § 629.42 (1992). Specifically, the SAA required state and local governments receiving federal financial assistance in excess of \$100,000 a year to have an annual audit.⁶ 29 C.F.R. § 96.101 (1992). The audit requirements in OMB Circular No. A-128 are to be followed for audits of "all fiscal years beginning after December 31, 1984." 29 C.F.R. § 96.102 (1992). Section 96.504 provided that recipients are responsible for ensuring that subrecipients to whom they provide \$25,000 or more in a fiscal year are audited and that any audit findings are resolved. 29 C.F.R. § 96.504 (1993-1998). The regulation further provided that the recipient shall ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of non-compliance with federal law and regulations. 29 C.F.R. § 96.504(c) (1993-1998).

⁶ The regulation further provides that governmental units receiving between \$25,000 and \$100,000 annually may follow either the audit requirements of the SAA or those contained in the federal statutes and regulations under which such federal assistance is provided. 20 C.F.R. § 96.101 (1992).

The regulations published to implement the 1992 JTPA amendments also required governmental recipients to comply with the SAA and 29 C.F.R. Part 96. *See* 20 C.F.R. § 627.480 (1993-1995). Certain sections in Part 629 were shifted to Part 627, including the requirement to follow 29 C.F.R. Part 96, which appears at 20 C.F.R. § 627.480 (1993).⁷ 57 Fed. Reg. 62004, 62006 (Dec. 29, 1992). Specifically, the regulations at 20 C.F.R. § 627.480(a) (1993-1996) required governmental recipients and subrecipients of JTPA funds to comply with the SAA and 29 C.F.R. Part 96. With the exception of the addition of paragraph (a)(3) affecting commercial organizations, the changes in Section 627.480 were not substantive but were intended solely to more clearly delineate existing requirements. 57 Fed. Reg. 62004, 62016.

The SAA was amended in 1996 and resulted in a change in use of OMB Circular No. A-128 for audits of state and local governments to OMB Circular No. A-133. Pub.L. 104-156, § 2 (July 5, 1996), 110 Stat. 1396. The change became effective for audits of fiscal years beginning after June 30, 1996. Pub.L. 104-156, § 3, 110 Stat. 1404. The revision of OMB Circular No. A-133 established uniform audit requirements for non-Federal entities that administer Federal awards and implemented the SAA Amendments of 1996. 62 Fed. Reg. 35278 (June 30, 1997). In addition, OMB Circular No. A-128 was rescinded as a result of the consolidation of the audit requirements under Circular A-133, and the threshold for when an entity is required to have an audit was raised from \$25,000 to \$300,000. *Id.*

In the present matter, the parties have stipulated that all of the disallowed costs at issue were for fiscal years beginning before July 1, 1996. Consequently, I conclude that the SAA Amendments of 1996 and OMB Circular No. A-133, which became effective for fiscal years beginning after June 30, 1996, do not apply to the disallowed costs during the fiscal years in this case. I further conclude that the annual audit requirements of OMB Circular No. A-128, as referenced in 20 C.F.R. § 627.480(a) (1993-1996), do apply to the disallowed costs for fiscal years 1993, 1994, 1995, and 1996.

Similarly, the Commonwealth's Policy Directive 94-07 (October 6, 1994) states that "[c]onsistent with federal regulations, DET policy has required each SDA to obtain an annual financial and compliance audit of JTPA funds." Decision and Order at 17; GX 2 at 655. The Policy Directive specifically references the SAA, OMB Circular No. A-128, the JTPA, and the relevant regulations. GX 2 at 655-657. Thus, both the SAA and the Commonwealth's policies require an annual audit of subrecipients.

In sum, I conclude that the audit requirements of Section 164(a) of the JTPA, 15 U.S.C. § 1574(a)(2) (1988), and its implementing regulations, 20 C.F.R. parts 626-631 (1992), apply to the disallowed costs for fiscal year 1993 (program year 1992). *See* 54 Fed. Reg. 39118 (Sept. 29, 1989). *See also* 58 Fed. Reg. 31471, 31472 (June 3, 1993). I further conclude that Section 142 of the 1992 amendments to the JTPA, 15 U.S.C. § 1574(a)(2) (1994), and the interim final

⁷ Various sections that previously appeared in 20 C.F.R. Parts 627, 628, 629, and 630 have been shifted to Parts 627 and 628. 57 Fed. Reg. 62004, 62006 (Dec. 29, 1992). As specified at Part 626, Introduction to the Regulations under the Job Training and Partnership Act, Part 627 applies to all programs under titles I, II, and III of the Act, except where noted, and Part 628 generally applies to title II programs. *Id.* Parts 629 and 630 were reserved for future use, while Part 631 continued to apply to title III programs. *Id.*

regulations, 20 C.F.R. Parts 626-628, and 631 (1993),⁸ requiring that all financial transactions and records maintained be in accordance with GAAP are to be applied to the disallowed costs for fiscal years 1994-1995 (program years 1993-1994). *See* Pub.L.No. 102-367 (Sept. 7 1992), 106 Stat. 1021, 1046. *See also* 57 Fed. Reg. 62004 (Dec. 29, 1992).⁹ I additionally find that Section 142 of the 1992 Amendments and the final regulations, 20 C.F.R. Parts 626-628, 629, and 630-631 (1994-1997), which continued to require the application of GAAP in all financial transactions and records maintained, are to be applied to the disallowed costs for fiscal year 1996. *See* 59 Fed. Reg. 45760 (September 2, 1994). Lastly, I conclude that the annual audit requirements, including taking appropriate corrective action to resolve audit findings, found in the SAA, OMB Circular No. A-128, and the Commonwealth's Policy Directive 94-07 apply to all of the fiscal years in question.

C. Summary of Disallowed Costs

The Commonwealth contends that it has submitted documentation which shows that the actual amount of properly disallowed JTPA costs is \$1,829,646 or \$1,504,533 for Title II and \$325,113 for Title III. Commonwealth's Post-hearing Brief at 15. The Grant Officer rejected the documentation and arguments submitted by the Commonwealth on remand, and he concluded in his Revised Final Determination that JTPA costs in the amount of \$9,107,986 remained disallowed. GX 2 at 12. The Grant Officer did acknowledge that the Commonwealth had submitted adequate documentation to support allowance of \$182,605 in JTPA expenditures if they had been verified by an A-133 or special procedures audit. *Id.* However, he concluded that all costs must remain disallowed because without an audit, "there is no way for ETA [Employment and Training Administration] to know if the organizations that received the funds provided services to eligible JTPA participants or, if the costs were for administration, whether the costs were within the cost ceiling for administrative expenditures." *Id.* In addition, at the hearing, the Grant Officer's witness, Mr. Salgado, testified "there's no way I could reasonably allow any cost without the audit." TR 139; Decision and Order 16.

D. Analysis

The changes in the JTPA and its implementing regulations as outlined clearly demonstrate an intent to strengthen fiscal and program accountability in JTPA programs. During the time periods in question, Section 164 required that each state establish fiscal control and accounting procedures to assure proper disbursement and accounting for federal funds. 15 U.S.C. § 1574(a)(1) (1994). The State's procedures must ensure that financial transactions are conducted and records maintained in accordance with GAAP. *Id.* Furthermore, Section 165(a)(1) of the Act required recipients to keep records that are sufficient to permit the tracing of funds to a level of expenditure adequate to insure that the funds have not been spent unlawfully. 15 U.S.C. § 1575(a)(1) (1994). Likewise, the regulations implementing the amended statute required

⁸ See note 7, *supra*.

⁹ The expiration date of June 1, 1993 for the interim final rule published at 57 Fed. Reg. 62004 (December 29, 1992) was extended indefinitely, and the U.S. Department of Labor indicated that it planned to issue a final rule on or before September 1, 1993. 58 Fed. Reg. 31471 (June 3, 1993). Notwithstanding the publication of the final rule, the 1992 amendments to the JTPA, and the resulting changes, became effective and operational July 1, 1993. *Id.*

recipients and subrecipients to provide records and reports that are uniform in definition, accessible to authorized federal and state staff, verifiable for monitoring, reporting, audit, program management and evaluation purposes. 20 C.F.R. § 627.425(a)(1) (1994). Although the specific audit requirements of Section 164 were removed from the JTPA, the requirements of the SAA, which were incorporated into the JTPA regulations, placed comparable responsibilities upon JTPA recipients and subrecipients to conduct annual audits. 20 C.F.R. Part 96 (1994). Additionally, the Commonwealth's Policy Directive 94-07 required annual audits in compliance with the SAA. GX 2 at 655. Moreover, courts have consistently held that record keeping requirements of the JTPA and its predecessor legislation, the Comprehensive Employment and Training Act (CETA), are critical to the oversight and evaluation provisions and that a recipient's failure to comply with record keeping requirements amounts to an unlawful spending of funds. *Louisiana v. Dept. of Labor*, 108 F.3d 614, 618 (5th Cir. 1997) (*Louisiana*), *cert. denied*, 522 U.S. 823 (1997); *Montgomery County v. Dept. of Labor*, 757 F.2d 1510, 1513 (4th Cir. 1985); *City of Oakland v. Donovan*, 703 F.2d 1104, 1107 (9th Cir. 1983), *modified*, 707 F.2d 1013 (9th Cir. 1983). Thus, the amended JTPA and regulations required the Commonwealth to ensure that all financial transactions and records maintained were in accordance with GAAP and required the Commonwealth to maintain records and reports that could be verified, monitored, audited and evaluated by the Grant Officer. In addition, the regulations required the Commonwealth to conduct annual audits of the Lynn SDA which are consistent with OMB Circular No. A-128 and to take appropriate corrective action to resolve audit findings.

With the 1992 JTPA Amendments and amended regulations in mind, I will review my previous findings regarding the parties' respective burdens. Pursuant to 20 C.F.R. § 627.802(e) (1993-1997), the Grant Officer bears the burden of production to support his decision, and the party seeking to overturn the decision bears the burden of persuasion. The Grant Officer must produce evidence sufficient to establish a *prima facie* case, which requires evidence sufficient for a reasonable person to conclude that JTPA funds were spent unlawfully. *Texas Department of Commerce v. U.S. Department of Labor*, 137 F.3d 329, 332 (5th Cir. 1998) (*Texas Commerce*). If the records are inadequate to show that the JTPA funds were spent lawfully, the Grant Officer has met its burden by establishing the inadequacy of the records. *Id.* at 332.

The Grant Officer concluded in his Revised Final Determination that JTPA costs in the amount of \$9,107,986.00 remained disallowed. Decision and Order at 16; GX 2 at 12. The Grant Officer acknowledged that the Commonwealth had submitted adequate documentation to support allowance of \$182,605 in JTPA costs.¹⁰ GO's Post-hearing Brief at 18-19; Decision and Order at 16. However, the Grant Officer contends that these costs must be disallowed because they were never audited. GO's Post-hearing Brief at 19. In support of his decision, the Grant Officer argues that Mr. Salgado testified that he was concerned about the Commonwealth's compliance with several provisions of the JTPA regulations in evaluating the allowability of the costs claimed, including Section 627.435 (Cost principles and Allowable Costs), Section 627.440 (Classification of Costs), and Section 427.445 (Limitations on certain costs), and that the documentation submitted by the Commonwealth did not address compliance with these

¹⁰ The total of \$182,605 is derived from the following expenses: Sheet #1 Payables (fiscal year 1996), \$60,750; Sheet #2 (fiscal year 1995), \$89,173; Payments by Corporation for Business, Work and Learning (CBWL)/Industrial Services Program (ISP) to vendors, \$8,682; and Additional Payments by CBWL/ISP, \$24,000. GO's Post-hearing Brief at 18.

particular provisions.¹¹ GO's Supplemental Brief at 5; GO's Post-hearing Brief at 18-19. Furthermore, the Grant Officer maintains that the changes in the JTPA regulations do not affect his argument concerning the allowability of these costs. GO's Supplemental Brief at 5.

Moreover, the Grant Officer argues that pursuant to the SAA, OMB Circular No. A-128 and the Commonwealth's Policy Directive 94-07, the Commonwealth and the City of Lynn were required to conduct an annual audit of JTPA costs incurred by the Lynn SDA, and neither entity conducted such an audit for fiscal years 1995 and 1996. GO's Supplemental Brief at 4-5. The Grant Officer does acknowledge that only OMB Circular No. A-128 applies to the time periods in question. GO's Supplemental Brief at 6. He explains that the reference to an "A-133 or special procedures audit" in the November 8, 1999 Grant Officer's Revised Final Determination was due to the fact that OMB Circular No. A-133 was in effect at the time of the report. *Id.* He contends that the point was that the costs offered by the Commonwealth to reduce the amount of disallowed costs should be audited in order to comply with JTPA requirements. *Id.* As a result, the Grant Officer argues that an audit was necessary to determine whether the Commonwealth complied with these provisions. GO's Post-hearing Brief at 18-19.

The JTPA and regulations were amended with the intent to increase program accountability and strengthen financial responsibility. To accomplish this purpose the audit requirements of the JTPA were replaced with language requiring application of GAAP in all financial transactions and maintenance of records. *See* 29 U.S.C. § 1574(a) (1994). Section 627.425(b) of the applicable regulations was revised to reflect the statutory requirement of GAAP and to clarify that responsibility for the adequacy of financial management systems of JTPA subrecipients is the responsibility of each recipient and the responsibility of the state. 20 C.F.R. § 627.425(b) (1994). Notwithstanding the amendments to the JTPA language in 1992, requirements to conduct annual audits pursuant to the SAA and OMB Circular No. A-128 continued to be an integral part of the regulations as previously discussed. Moreover, an audit of an entity's financial statements requires a determination of whether the financial statements present fairly the financial position and the results of financial operations in accordance with GAAP as part of the audit scope. 57 Fed. Reg. 62004, 62012. Hence, the Commonwealth's fulfillment of the audit responsibilities of the JTPA could demonstrate that transactions were conducted and records maintained in accordance with GAAP and allow for the tracing of funds to a level of expenditure adequate to insure that the funds have not been spent unlawfully.

There is no dispute that the required audits of the Lynn SDA were not performed for the fiscal years 1995 and 1996.¹² *See, e.g.,* Commonwealth's Post-hearing Brief at 5. In addition, the Grant Officer has offered testimony that the documentation submitted by the Commonwealth failed to allow him to adequately trace the funds as required under the Act. In light of the increased program accountability and strengthened financial responsibilities placed upon the

¹¹ Although the Grant Officer cites to the interim final regulations at 20 C.F.R. Part 627 (1993) and the final regulations at 20 C.F.R. Part 627 (1995) in his brief, he does not identify which provisions the witness was referring to in his testimony. Nevertheless, as I previously discussed, the changes from the interim final regulations to the final regulations for the relevant provisions were not substantive and do not significantly impact my analysis.

¹² I note that the Commonwealth maintains that certain payments made by CBWL/ISP directly to vendors under Title III were audited as part of an audit of CBWL/ISP. Commonwealth's Post-hearing Brief at 12-14. I will address this argument later in the decision.

Commonwealth by the amended JTPA and resulting regulations, I conclude that substantial evidence exists to support the Grant Officer's determination that the Commonwealth failed to maintain accurate and reliable financial records sufficient to permit the tracing of funds to insure that the funds were not spent unlawfully. *See Louisiana*, 108 F.3d at 618. Accordingly, I find that the Grant Officer has met his burden of establishing a *prima facie* violation of the JTPA; that is, evidence sufficient for a reasonable person to conclude that the disallowed funds were misspent within the meaning of the JTPA.

The next issue for consideration is whether the Commonwealth has met its burden of persuasion to show that, notwithstanding the failure to comply with the above-cited provisions, any of the disallowed costs were properly expended for lawful JTPA purposes. The Commonwealth has submitted a Reconstructed Trial Balance (RTB) for fiscal year 1995 Title II expenses which it obtained from the Lynn SDA because the Commonwealth was unable to obtain a Financial Status Report (FSR) that was traceable to source documentation from the Lynn SDA. GX 3 at 2. The RTB was prepared by a "certified public accountant" (CPA)¹³ hired to oversee a reconstruction sufficient to produce an auditable set of financial records, and it showed \$4,861,178 in costs that were properly expended and \$1,049,288 that were properly disallowed. GX 3 at 2, 7-28. In addition to the RTB, the Commonwealth submitted monthly balance sheets that were used to compile the summary information. GX 3 at 12-16. The Commonwealth had the RTB documentation reviewed by the fiscal representatives of the Executive Office of the Economic Affairs (EOEA) and the Commonwealth's JTPA Title II and III oversight agencies, who determined that the "approach appeared adequate to accomplish the required purpose and desired outcome." GX 3 at 3.

The Commonwealth also had its State Auditor review NET and the RTB as part of a special-scope review. GX 1 at 161-185. The State Auditor's report found that deficiencies in NET's accounting system and its lack of basic accounting controls precluded it from completely and accurately accounting for and reporting all revenues received and expenses incurred. *Id.* at 172. The report stated that prior to the arrival of the consultant who prepared the RTB, NET had not properly conducted expense allocations for several years and this was a source of increasing concern to the EOEA and other state agencies. *Id.* at 174. The review revealed that the reported fiscal year 1995 deficits were not accurate and that the JTPA programs may have incurred deficits rather than having broken even as stated in the RTB. *Id.* The State Auditor found that for 23 of the 77 fiscal year 1995 expenditures reviewed, totaling \$56,654, there were no invoices, contracts or explanation of the purpose of the expenditure in the files. *Id.* at 172. Furthermore, it found that over \$23,000 of non-JTPA Culinary Arts/Boardroom program expenditures may have been JTPA-related. *Id.* at 175. The State Auditor's report acknowledged that NET's failure to maintain an adequate accounting system and to conduct an annual audit are contrary to the regulations applicable to JTPA grants, specifically Sections 627.425 and 627.480, and contrary to the Commonwealth's Policy Directive 94-07. *Id.* at 175-176. The State Auditor recommended that the services of an independent private accountant be retained to evaluate the

¹³ I note that although the Commonwealth has stated that the RTB was prepared by a "certified public accountant", the Grant Officer refers to the preparer as a "consultant." *See, e.g.,* Commonwealth's Post-hearing Brief at 7; GX 3 at 2; GO's Post-hearing Brief at 7; GX 2 at 9. The question raised as to whether the RTB was prepared by a CPA or a consultant is of no consequence in view of my finding, *infra*, that the RTB is insufficient to satisfy the audit requirements of the JTPA.

situation and determine what must be accomplished to develop credible financial statements for NET for fiscal years 1995 and 1996. *Id.* at 176.

The applicable regulations require, *inter alia*, that a recipient of JTPA funds ensure that their own financial systems, as well as those of their subrecipients, provide fiscal control and accounting procedures in accordance with GAAP that are sufficient to permit the preparation of required reports and the tracing of funds to a level of expenditure adequate to establish that the funds have not been used in violation of the applicable restrictions. 20 C.F.R. § 627.425(b) (1995-1997). The SAA and OMB Circular No. A-128 require that a state shall determine whether the subrecipient has met the audit requirements of the Circular and determine whether the subrecipient spent the funds provided in accordance with applicable laws and regulations by reviewing an audit of the subrecipient or through other means (*e.g.* program reviews) if the subrecipient has not yet had such an audit.¹⁴ OMB Circular No. A-128, § 9. In the absence of an audit, the Commonwealth attempted to utilize a special-scope review and the RTB to determine whether the subrecipient spent the funds provided in accordance with applicable laws and regulations. However, the State Auditor's report clearly demonstrates that the RTB contained several discrepancies regarding NET's expenditures. Furthermore, the evidence does not demonstrate that the RTB was conducted in accordance with GAAP. As the Grant Officer points out, the Commonwealth concluded that NET remains unable to prepare the required financial reports which would permit the Commonwealth to trace awarded funds to a level of expenditure that is adequate to establish that the funds were not used in violation of the applicable regulations. GO's Supplemental Brief at 8. Absent an audit and/or other source documentation to demonstrate that the RTB was produced in accordance with GAAP which allows the tracing of funds to determine if they were spent lawfully, the Grant Officer was unable to determine whether the Commonwealth or the Lynn SDA complied with the applicable statutory and regulatory requirements of the JTPA. In my view, the Commonwealth's failure to comply with the audit requirements and, more importantly, its failure to demonstrate the adequacy of the financial management systems of its JTPA subrecipient amounts to noncompliance with the requirements of the JTPA. The Commonwealth, as recipient of the JTPA funds, was statutorily obligated to ensure that those funds, including those passed on to subrecipients, were expended properly. It failed to do this. Consequently, I find that the RTB documentation submitted by the Commonwealth is insufficient to establish that the Lynn SDA's financial systems provided fiscal control and accounting procedures in accordance with GAAP and are insufficient to permit the preparation of required reports and the tracing of funds to a level of expenditure adequate to establish that the funds have not been used in violation of the applicable restrictions pursuant to 20 C.F.R. § 627.425(b) (1995-1997). Accordingly, the Grant Officer's disallowance of \$4,861,178 in fiscal year 1995 Title II costs is affirmed.¹⁵

¹⁴ The Circular further requires the state to take appropriate corrective action within six months after receipt of the audit in instances of noncompliance with federal laws and regulations; to consider whether subrecipient audits necessitate adjustment of recipient's own records; and to require each subrecipient to permit independent auditors to have access to the records and financial statements as necessary to comply with the Circular. OMB Circular No. A1-28, § 9.

¹⁵ Given that I have upheld the GO's disallowance of the fiscal year 1995 Title II costs, I find it unnecessary to reach the issue of judicial estoppel based on the Commonwealth's alleged adoption of inconsistent positions regarding the RTB.

I have reconsidered my previous findings regarding the documentation submitted by the Commonwealth, including the weekly invoice records for fiscal year 1996 costs and other documentation for Title III costs. A review of the record in light of the amended statutory and regulatory provisions does not alter my conclusions affirming the Grant Officer's disallowance of these costs. First, the Commonwealth submitted documentation claiming that it supported \$1,827,340 in valid expenses of the total \$2,080,188 in Title II grants for fiscal year 1996, and, therefore, it estimated \$252,848 was properly disallowed. GO's Post-hearing Brief at 11; GX 2 at 10. However, Dennis Lonergan, Administrative Officer for USDOL's ETA office in Boston, testified without contradiction that the Commonwealth's Title II documentation for fiscal year 1996 lacked supporting records such as copies of individual invoices and checks showing that the expenditures complied with GAAP and were actually made for appropriate JTPA purposes. TR 47-51. Mr. Lonergan's testimony is supported by the State Auditor's Report which reported that deficiencies in NET's accounting system and its lack of basic accounting controls were such that NET was unable to produce a balance sheet and income and expense statement throughout the entire fiscal year ending June 30, 1996. GX 1 at 172. In particular, the State Auditor found that "NET did not maintain invoices or other documentation in support of all its expenditures." *Id.* The report also noted that although the cost allocation process was performed for fiscal year 1995, it was not performed for fiscal year 1996. *Id.* at 174. The report concluded that NET's accounting system did not permit a complete and accurate accounting and reporting of revenues. *Id.* at 162. Furthermore, the report stated that the deficiencies were such that NET was unable to produce a balance sheet and income and expense statement throughout the entire fiscal year ending June 30, 1996. *Id.* It also found that NETSTOP (NET's retail stores) funds had been used to pay at least \$59,857 in expenses that appeared to be attributable to one or more JTPA programs during fiscal year 1996. *Id.* at 173. Based on this evidence, I find that the records submitted were insufficient to permit the preparation of required reports, e.g. the documentation was "unauditable," and insufficient to permit the tracing of funds to a level of expenditure to insure that the funds were not spent unlawfully in accordance with applicable statutory and regulatory provisions. Accordingly, I conclude that the documentation is insufficient to support allowance of the challenged \$2,080,188 in Title II funds for fiscal year 1996. *See* 29 U.S.C. § 1575(a)(1) (1994); 20 C.F.R. § 627.425(b)(1) and (2) (1994-1997). Consequently, the Grant Officer's disallowance of \$2,080,188 in Title II funds for fiscal year 1996 is affirmed.

Second, I find for similar reasons that the Grant Officer properly disallowed the Title III costs for which the Commonwealth submitted additional documentation. The Commonwealth became aware during fiscal year 1995 that the Lynn SDA was not adhering to JTPA regulations or the policies set forth by its Title III oversight entities, CBWL/ISP. As a result of these deficiencies, CBWL/ISP assumed responsibility during fiscal year 1995 for direct operation of some JTPA Title III programs previously administered by the Lynn SDA, and it began to exercise extensive oversight of other Title III programs before releasing any JTPA funds to NET. GX 3 at 4; TR 320-23. Elizabeth Durkin, the Director of Monitoring for CBWL/ISP, testified that the restrictions placed upon NET consisted of giving NET only formula funds and, beginning in fiscal year 1996, funding NET on a quarter-by-quarter basis. TR 324. Prior to releasing any funds to NET, CBWL/ISP staff reviewed supporting documentation on site at Lynn or had copies sent to them, such as invoices from and checks payable to various vendors. TR 328-30. Ms. Durkin further testified that as time went on, and NET had not implemented all the corrective actions they were supposed to be implementing, staff from CBWL/ISP reviewed bank

statements to ensure checks were actually cashed by the vendors whose name was on the check, and they verified payroll records against attendance records in addition to reviewing the actual checks disbursed. TR 329. She stated that later in the process CBWL/ISP staff went as far as calling vendors to ensure that they actually received and cashed the checks. TR 330. Ms. Durkin testified that the CBWL/ISP's monitoring and contacts produced positive results, and she was satisfied that the funds disbursed to NET were used for valid JTPA purposes. TR 329-30. She further testified that CBWL/ISP was annually audited as part of an independent audit and all of their records were available for auditing, including checks issued by CBWL/ISP to vendors or to NET and any supporting documentation CBWL/ISP maintained on these transactions. TR 351. However, upon cross-examination, Ms. Durkin testified that the supporting documentation maintained by her office consisted only of the funds request and checks disbursed, not "all of the back-up documentation" reviewed on site at NET because only a sampling of records at NET were copied. TR 351. Although Ms. Durkin testified that no problems were identified in the audits of CBWL/ISP, no audit report was submitted to the Grant Officer or offered into evidence. TR 334; GO's Post-hearing Brief at 16.

The Commonwealth has acknowledged \$325,113 in disallowed costs for fiscal year 1995, based upon CBWL/ISP's analysis of the reconciliation of expenditures and cash which NET performed for fiscal year 1995 and the cash requests and fiscal status reports (FSR) submitted to CBWL/ISP versus the amount of cash released to NET during fiscal years 1995 and 1996. GX 3 at 4. However, this analysis was never submitted to the Grant Officer. GO's Post-hearing Brief at 14; GX 2 at 10. Moreover, Mr. Lonergan testified that he reviewed the fiscal status reports, cash requests and checks disbursed, but he was unable to identify a particular FSR that related to a particular cash request or check disbursed, and there was no recap or summary sheet to function as a road map. TR 56-58. He concluded that since there was no verification or audit demonstrating that NET actually paid the salaries or vendors with the funds, he could not determine the accuracy of the \$325,113, nor could he determine whether the transactions or records complied with GAAP. TR 57-59.

In addition, the Commonwealth submitted documentation regarding payments of \$8,682 made directly to training vendors for services to JTPA recipients and an additional \$46,616 in payments made directly to vendors. GX 3 at 5. It also submitted documentation showing expenses incurred by CBWL/ISP in the closing of NET in the amount of \$89,248. *Id.* The Commonwealth further submitted two lists of payables, Sheet #1 listing \$76,031 in Title III payments to vendors for fiscal year 1996 and Sheet #2 listing \$182,466 in Title III payments to vendors for fiscal year 1995. GX 4 at 1, 87; GX 2 at 11; GO's Post-hearing Brief at 13-14. Mr. Lonergan testified that while some of the costs had supporting documentation, the documentation did not include information describing whether those costs were in compliance with the JTPA regulations, and it did not indicate that the costs had been subject to an audit. TR 63-73. The Revised Final Determination and Mr. Lonergan's testimony acknowledge that the Commonwealth submitted adequate documentation to support allowance of \$182,605 in JTPA Title III expenditures for fiscal year 1995 and 1996, had those expenditures been subject to an audit. *Id.*; GX 2 at 12. However, as the Grant Officer stated in his Revised Final Determination, without an audit of these expenses, there is no way for ETA to know if the organizations that received the funds provided services to eligible JTPA participants or, if the costs were for

administration, whether the costs were within the cost ceiling for administrative expenditures. GX 2 at 12.

As I have previously discussed, the amended JTPA and regulations required that financial transactions be conducted and records be maintained in accordance with GAAP, and the regulations further required an annual audit of JTPA funds. In addition, Section 108 of the JTPA and the regulations at 20 C.F.R. § 627.440 (1994) required that funds be charged or allocated to the appropriate cost category (administration, training-related and supportive services, or direct training services) based on the benefits received by each program. *See* 57 Fed. Reg. 62013-62014. Although the Commonwealth argues that an audit was performed on CBWL/ISP and its records, the audit findings were insufficient to conform to the applicable regulations since CBWL/ISP maintained only a sampling of the supporting documentation from NET. Moreover, as discussed above, no audit results were ever submitted to the Grant Officer. Noting the increased fiscal accountability of the amended JTPA and amended regulations and that the costs were not subject to an audit as required by the regulations, I affirm the Grant Officer's disallowance of \$182,605, consisting of \$60,750 for Payables Sheet #1 (fiscal year 1996), \$89,173 from Payables Sheet #2 (fiscal year 1995), \$8,682 in payments from CBWL/ISP to vendors, and \$24,000 in additional payments by CBWL/ISP. *See* 20 C.F.R. Part 96. Further, I affirm the Grant Officer's disallowance of the remaining Title III costs, namely \$15,282 from Payables Sheet #1, \$93,294 from Payables Sheet #2, \$89,248 in closing costs, and \$46,616 in additional payments from CBWL/ISP to vendors, because the documentation submitted by the Commonwealth was (1) insufficient to demonstrate that the financial transactions were conducted or records maintained in accordance with GAAP pursuant to 29 U.S.C. § 1574(a)(1), (2) insufficient to permit the tracing of funds to a level of expenditure adequate to insure that funds had not been spent unlawfully pursuant to 29 U.S.C. § 1575(a)(1), and (3) not subjected to an audit as required by 20 C.F.R. Part 96.

Accordingly, I affirm the Grant Officer's disallowance of \$9,107,986 in funds which were not expended in accordance with the JTPA, and I conclude that the Commonwealth must repay the same amount to the United States pursuant to 29 U.S.C. § 1574(d) (1998), unless it meets the conditions set forth in subsection (e) relating to waiver of a recipient's liability for subgrantee noncompliance, which is discussed below.

E. Waiver

Section 164(e)(3) of the JTPA provides for waiver of the imposition of sanctions against a recipient due to a subgrantee's misexpenditure of JTPA funds, if the recipient can adequately demonstrate that it substantially complied with the requirements set forth in Section 164(e)(2). 29 U.S.C. § 1574(e)(3) (1994);¹⁶ *Commissioner, Employment Security of the State of Washington v. U.S. Department of Labor*, USDOL/OALJ Reporter (PDF), OALJ Nos. 90-JTP-29, 91-JTP-11, 92-JTP-34, Sec'y Fin., September 13, 1995, slip op. at 4. (*Employment Security*). The JTPA contemplates relief for a recipient where it can demonstrate that it established appropriate standards of review and was diligent in adhering to those standards, but nevertheless could not reasonably prevent a subgrantee from violating the Act. *Id.* Specifically, Section 164(e)(2) of the JTPA provides:

¹⁶ I note that this particular section of the JTPA was not amended as a result of the 1992 JTPA Amendments.

(2) In determining whether to impose any sanction authorized by this section against a recipient for violations by a subgrantee of such recipient under this Act or the regulations under this Act, the Secretary shall first determine whether such recipient has adequately demonstrated that it has--

(A) established and adhered to an appropriate system for the award and monitoring of contracts with subgrantees which contains acceptable standards for ensuring accountability;

(B) entered into a written contract with such subgrantee which established clear goals and obligations in unambiguous terms;

(C) acted with due diligence to monitor the implementation of the subgrantee contract, including the carrying out of the appropriate monitoring activities (including audits) at reasonable intervals; and

(D) taken prompt and appropriate corrective action upon becoming aware of any evidence of a violation of this Act or the regulations under this Act by such subgrantee.

29 U.S.C. §1574(e)(2) (1994). In addition, Section 164(e)(3) authorizes the Secretary to impose appropriate sanctions directly against the mispending subgrantee. 29 U.S.C. §1574(e)(2) (1994); *Employment Security*, slip op. at 5. Moreover, the relevant regulations¹⁷ provide that:

(c) a waiver of the recipient's liability can only be considered by the Grant Officer when the misexpenditure of JTPA funds:

(1) occurred at the subrecipient level;

(2) was not a violation of section 164(e)(1) of the Act, or did not constitute fraud; or

(3) if the fraud did exist, it was perpetuated against the recipient/subrecipient; and:

(i) the recipient/subrecipient discovered, investigated, reported, and prosecuted the perpetrator of said fraud; and

(ii) After aggressive debt collection action, it can be documented that there is no likelihood of collection from the perpetrator of the fraud.

(4) The recipient has issued a final determination which disallows the misexpenditure, the recipient's appeal process has been exhausted, and a debt has been established; and

(5) The recipient requests such a waiver and provides documentation to demonstrate that it substantially complied with the requirements of section 164(e)(2) (A), (B), (C), and (D) of the Act.

¹⁷ The regulatory provisions formerly found at 20 C.F.R. Part 629, Subpart D, "Grievances, Investigations, and Hearings" have been revised, redesignated, and reordered in the interim final regulations in a new part 627, Subparts E, F, G, and H. 57 Fed. Reg. 62004, 62016. The "sanctions for violations of the Act" provisions formerly at 20 C.F.R. § 629.44 of the regulations have been moved into this part as a separate subpart. *Id.* The new Part 627, Subpart G consolidates the sanction provisions for violations of the Act into a more logical order, with separate sections addressing: sanctions and corrective actions (§ 627.702); the process for waiver of State liability (§ 627.704); the approval process for contemplated corrective actions (§ 627.706); and the provisions applicable to the use of "offset" for debts established against the State (§ 627.708). *Id.* at 62017.

20 C.F.R. § 627.704 (1996-1997).¹⁸ The Grant Officer concluded in his Revised Final Determination that the Commonwealth did not demonstrate that it substantially complied with requirements of Section 164(e)(2)(A), (B), (C), and (D) of the JTPA. GX 2 at 12-18. The Grant Officer argues that the Commonwealth did not demonstrate compliance with Section 164(e)(2)(A) because it failed to decertify the Lynn SDA's fiscal system according to its own Policy Directive 93-12 which requires that a "certified with conditions" status be downgraded to "out of compliance" if standards are not met within a specific time frame. GO's Post-hearing Brief at 23-25. The Grant Officer contends that despite continuing reports of the SDA's failure to correct the problems with its fiscal system, the Commonwealth did not decertify the SDA's fiscal system until April 10, 1996. *Id.* at 24. In addition, the Grant Officer maintains that the Commonwealth failed to comply with Policy Directive 94-07, which sets forth policies and procedures for the conduct of audits and resolution of audit findings, since the Lynn SDA did not have audits performed for fiscal years 1995 and 1996 and because questioned costs from the audit for fiscal year 1994 were not resolved by the Commonwealth. *Id.* at 25. The Grant Officer further determined that the Commonwealth had not demonstrated compliance with Section 164(e)(2)(B) regarding a contract with clear goals and obligations due to issues raised about the authority of the Mayor of Lynn to sign the contracts between Lynn and the Commonwealth. *Id.* at 26. Additionally, the Grant Officer determined that while the Commonwealth provided some evidence that it monitored the SDA, it "appears to have been so belated and hesitant in taking definitive action as to fail the requirement for due diligence" pursuant to Section 164(e)(2)(C). *Id.* at 28. Furthermore, the Grant Officer noted that the Commonwealth's failure to ensure that the SDA performed audits for fiscal years 1995 and 1996 also demonstrates that it failed to meet the due diligence criteria under Section 164(e)(2)(C). *Id.* at 28. Lastly, the Grant Officer states that the fact that it took four years from the time the Commonwealth became aware of problems with respect to the SDA's fiscal system for the Commonwealth to take definitive action demonstrates that the Commonwealth did not take prompt and appropriate corrective action as required under Section 164(e)(2)(D). *Id.* at 29. The Grant Officer again noted that the Commonwealth's failure to resolve the \$202,397 in disallowed costs from the SDA's fiscal year 1994 audit and the SDA's failures to perform audits for fiscal years 1995 and 1996 indicate the Commonwealth's deficiency in meeting the requirement to take prompt and appropriate action under Section 164(e)(2)(D). *Id.*

In response, the Commonwealth argues that it substantially complied with the requirements of section 164(e)(2) and that its Policy Directive 93-12 did not require it to designate NET's fiscal system as "out of compliance" in the Fall of 1994 as urged by the Grant Officer and previously determined by this Court. Commonwealth's Supplemental Brief at 3-4. In particular, the Commonwealth asserts that subsection (A) only requires that the recipient have a system for awarding and monitoring contracts, which the Grant Officer admitted it had, and that implementation of the system for awarding and monitoring contracts falls under subsections (C) and (D) not under (A). Commonwealth's Post-hearing Brief at 17. Furthermore, the Commonwealth contends that it met the requirements of subsection (B) by entering into written contracts with the Lynn SDA which established clear goals in unambiguous terms, including the

¹⁸ I note that 20 C.F.R. § 627.704 (1994-1995) provides essentially the same regulatory provisions, albeit under subsection (b), with minor numbering differences and no provision addressing situations whereby fraud is perpetuated against the recipient/subrecipient. These changes do not affect the application of the provisions to the matter at hand.

obligation to conduct annual audits, and that Mayor of Lynn's authority to sign contracts was established in the state proceedings. *Id.* at 18-19. Next, the Commonwealth asserts that it met the requirements of Section 164(e)(2)(C) to act with due diligence in monitoring contracts with the Lynn SDA and that the National and Regional Employment and Training Administration (ETA) Offices recognized such action. *Id.* at 20. The Commonwealth specifically cites to the statement of the Grant Officer at page 12 of the May 13, 1998 Final Determination, that "the audit and corrective action record establish that the State recipient took appropriate and diligent action, as set out [in] Section 164(e)(2) and 164(b)(1) of the JTPA, in bringing to light and terminating subgrantee misexpenditures that constituted wilful [sic] disregard of the requirements established at Section 164(e)(1) of the JTPA." *Id.* (emphasis in original); GX 1 at 12. In addition, the Commonwealth argues that its position is further supported by statements made by Mary Ward, Technical Assistance and Training Coordinator, at the Boston ETA Office in letters to Senator Kennedy and to Diane Salemy, Deputy Director for Administration for the Commonwealth, stating that the Commonwealth properly performed its JTPA compliance functions and acted with diligence in resolving the matter with the Lynn SDA. *Id.* at 21. Moreover, the Commonwealth asserts that the problems occurring in fiscal years 1992, 1993, and 1994 were not the same type or magnitude as the problems occurring in later years and that it chose to work with the SDA to solve the problems rather than to sanction it. *Id.* at 22. It further argues that it put the SDA on notice of the audit requirements and the SDA's failure to obtain these was beyond the Commonwealth's control. *Id.* at 23. Lastly, the Commonwealth maintains that it took prompt and appropriate corrective action in dealing with the Lynn SDA in accordance with Section 164(e)(2)(D). *Id.* In particular, it notes that as the problems with the Lynn SDA escalated, the Commonwealth's actions increased. *Id.* at 24. It further contends that it advised the Boston ETA Office and the Department of Labor of the problems, that ETA agreed with its corrective action plan and that it was never advised to decertify the Lynn SDA. *Id.* Moreover, the Commonwealth argues that its Policy Directive 93-12 allowed for discretion when determining whether to downgrade a system from "certified with conditions" to "out of compliance." Commonwealth's Supplemental Brief at 3-4. It argues that the downgrading was not necessary since the problems were of a different magnitude or type than the earlier ones and since it put into place measures to ensure that the Lynn SDA was spending JTPA funds properly such as increasing the frequency of monitoring visits, establishing special funding restrictions, designating it as a High-Risk Subrecipient. *Id.* at 3-5.

In my first decision and order, I concluded that the Commonwealth, having failed to comply with its own monitoring policies (Policy Directive 93-12), had not demonstrated that it adhered to an appropriate system for the award and monitoring of contracts with its subgrantees as required by Section 164(e)(2)(A). Decision and Order at 21. It remains my view that while the Commonwealth had a system for awarding and monitoring contracts in place, it did not adhere to its system of monitoring as required by Section 164(e)(2)(A). The Commonwealth's own policies (Policy Directive 94-07) required it to ensure that annual audits were conducted and audit findings resolved in a timely manner. The Commonwealth did not do this. More importantly, as explained below, the Commonwealth did not follow its own monitoring policies as laid out in Policy Directive 93-12 in downgrading the status of NET's financial system. I do agree with the Commonwealth that it complied with subsection (B), and I find that the Commonwealth entered into written contracts with the Lynn SDA which established clear goals and obligations in unambiguous terms as evidenced by its Grant Agreements. GX 1 at 55-111. I

also find that the issue of the Mayor's authority to sign contracts for the City of Lynn was resolved during the State proceedings. *See* GX 1 at 137-138, 141-142, and 156-159.

On the other hand, I am not persuaded that the Commonwealth acted with the due diligence required by Section 164(e)(2)(C) in monitoring the implementation of its contract with the Lynn SDA, which includes carrying out appropriate monitoring activities such as audits. Nor am I persuaded that the Commonwealth took prompt and appropriate corrective action upon becoming aware of any evidence of a violation of Section 164 or the regulations as required by Section 164(e)(2)(D). The Commonwealth conditionally certified the SDA's fiscal system as early as October 1993, but it did not move to decertify the fiscal system until April 10, 1996, despite clear ongoing problems with that system. GX 190-191. For example, in a letter dated September 12, 1994, the Commonwealth noted in its report of findings from fiscal monitoring visits conducted on January 5 and 6, and February 3, 1994, that, *inter alia*, NET's fiscal year 1992 audit had findings of "inadequate documentation of Fiscal Status Reports" which were repeated from fiscal year 1991 and had yet to be resolved. GX 2 at 1147-1160. Notwithstanding this finding, the Commonwealth again conditionally approved NET's fiscal system. *Id.* In addition, the audit of the Commonwealth's federal financial assistance programs for fiscal year 1996 revealed in finding number 13 that "monitoring of subrecipient needs improvement" and recommended that the Executive Office of Economic Affairs¹⁹ monitor the subrecipient's action plan to correct all findings and revise its present procedures to incorporate the recommendation. GX 1 at 46. The auditors further declared in finding number 14 that "subrecipient single audit monitoring needs improvement." *Id.* at 47. They specifically noted the following: (1) as of October 4, 1996, the City of Lynn had not submitted an audit report for the period ending June 30, 1995 which was due by July 31, 1996; (2) that for fiscal year 1996, the Grants Management Unit of the Executive Office of Economic Affairs did not ensure that subrecipients had submitted and implemented corrective action plans within six months from the receipt of the subrecipients' audit reports in accordance with OMB Circular No. A-128; and (3) five out of the fifteen reports received contained findings that had been reported in previous years "indicating that although the agency has formal procedures for addressing and correcting the findings with the subrecipients, the subrecipients' corrective action plans were either not implemented or effective in correcting the related weakness(es)." *Id.* The audit further found that while the Grants Management Unit noted "material questioned costs" in the 1994 audit report of the City of Lynn and worked with the subrecipient to develop and implement a corrective action plan, the subrecipient did not successfully implement the plan. *Id.* at 48. The report did recognize that the Grants Management Unit intensified its monitoring activities and eventually decertified the subrecipient; yet, it also acknowledged that the review of the subrecipient confirmed that the subrecipient had not complied with certain regulations established by the JTPA and OMB Circular No. A-128. *Id.*

Moreover, the State Auditor's Report on NET supports the conclusion that the Commonwealth did not take effective corrective action. *See* GX 1 at 161-185. The Auditor reviewed numerous reports prepared by the state agencies with oversight responsibilities over NET, finding that the recurring theme of the reports is that NET did not have adequate control over its financial resources and that "effective and corrective actions were not implemented to

¹⁹ I note that the auditor's report refers to the Executive Office of Economic Affairs using the abbreviation "SEA." *See, e.g.*, GX 1 at 47. To avoid confusion, I will simply use the agency's full title when discussing the report's finding.

resolve the deficiencies.” *Id.* at 172-173. In addition to the requirements of OMB Circular No. A-128, the Commonwealth’s Policy Directive 94-07 required that audits of the Lynn SDA be conducted annually, that audits be conducted and completed within twelve months after the end of the fiscal year, and that required reports be submitted to the funding source within one month of completion. GX 2 at 662-663. The Lynn SDA did not have the required audits performed for fiscal year 1995 and 1996. Furthermore, the Policy Directive required resolution of audit findings. *Id.* at 665. But, questioned costs from fiscal year 1994 audit in the amount of \$202,397 were not promptly resolved by the Commonwealth. Accordingly, I am compelled to find that the Commonwealth did not act with due diligence in monitoring the implementation of the subgrantee contract, including the carrying out of monitoring activities (including audits) at reasonable intervals as required to comply with Section 164(e)(2)(C).

Lastly, the Commonwealth’s Policy Directive and OMB Circular No. A-128 require that corrective action be instituted within six months. GX 2 at 665. As the audit report noted, the Commonwealth did not do this in fiscal year 1995. GX 1 at 48. Furthermore, the Commonwealth pursuant to Policy Directive 93-12 could have downgraded the Lynn SDA to “out of compliance” status in September 1994. GX 2 at 542-43. However, it conditionally approved the SDA’s fiscal system despite NET’s fiscal year 1992 audit problems such as inappropriate indirect cost allocation plan, excess cash on hand (Title II), poor cash management, inadequate documentation of fiscal status reports, and poor property management which were repeated from fiscal year 1991 and had yet to be resolved. GX 2 at 1153. Similarly, the Commonwealth and the SDA failed to resolve the audits in a timely manner as required by Policy Directive 94-07 and OMB Circular A-128. Based on its own finding that the SDA’s fiscal system was not in compliance with state standards and/or federal statute and regulations, the Commonwealth should have downgraded the SDA to “out of compliance” status in accordance with Policy Directive 93-12 in September 1994. GX 2 at 542. I find that by failing to downgrade the Lynn SDA in September 1994, the Commonwealth did not take prompt and appropriate corrective action upon becoming aware of evidence of a violation of the JTPA and its regulations by the subgrantee as required by Section 164(e)(2)(D). On these facts, I conclude that the Commonwealth has not demonstrated substantial compliance with the requirements of Section 164(e)(2) and may not avail itself of the JTPA’s waiver of liability provisions. 29 U.S.C. § 1574(e)(3) (1998); *Commonwealth of Pennsylvania v. U.S. Dept. of Labor*, USDOL/OALJ Reporter (HTML) Case No. 92-JTPA-12 at 3 (Sec’y April 5, 1995) (holding that the Secretary lacked the statutory or regulatory authority to waive the debt incurred by the state because the state had failed to demonstrate substantial compliance with the prescribed statutory requirements).

Moreover, pursuant to the applicable JTPA regulations, the Secretary can only consider a request for a waiver of a recipient’s liability when the misexpenditure of JTPA funds did not constitute a violation of Section 164(e)(1) of the JTPA. 20 C.F.R. § 627.704(c)(2) (1995-1997). Section 164(e)(1) of the JTPA requires a recipient to repay amounts not expended in accordance with the JTPA when the Grant Officer determines that the misexpenditure of funds was due to willful disregard of the requirements of the JTPA, gross negligence, or failure to observe accepted standards of administration. *Id.*; 29 U.S.C. § 1574(e)(1) (1998). The Grant Officer contends that a determination was made in the Revised Final Determination that a violation of section 164(e)(1) occurred because the Lynn SDA willfully disregarded the JTPA by failing to

obtain the required audits for fiscal years 1995 and 1996, and it failed to follow accepted standards of administration in that the Lynn SDA failed to maintain an accounting system in accordance with the JTPA standards for financial management found at 20 C.F.R. § 627.425(b). GO's Post-hearing Brief at 30. The Commonwealth disagrees with this determination and argues that it took appropriate action as provided in its established policies when the Lynn SDA failed to comply fully with a corrective action plan and failed to have audits completed for fiscal years 1995 and 1996. Commonwealth's Post-hearing Brief at 26. As I have already determined, the Commonwealth did not follow its own policies in monitoring its contracts with the Lynn SDA, it did not act with due diligence in carrying out the appropriate monitoring activities, and it did not take prompt and appropriate corrective action upon becoming aware of evidence of violations of the JTPA. Therefore, I find that the Grant Officer properly determined that the Commonwealth failed to observe accepted standards of administration, and that the Commonwealth is liable to repay the misexpended funds in the amount of \$9,107,986. *See* 29 U.S.C. § 1574(e)(1) (1998).

ORDER

The Grant Officer's determination to disallow JTPA costs is **AFFIRMED**. The Grant Officer's determination to deny the Commonwealth's request for a waiver of repayment of disallowed costs is **AFFIRMED**. Accordingly, the Commonwealth of Massachusetts shall repay from non-federal funds the sum of \$9,107,986 to the United States Department of Labor pursuant to 29 U.S.C. § 1575(e)(1)(1998).

SO ORDERED.

A

DANIEL F. SUTTON
Administrative Law Judge

Boston, Massachusetts