DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: California Department of Benefit Payments DATE: March 31, 1981
Docket Nos. 78-75-CA-SS 78-80-CA-SS
78-76-CA-SS 78-81-CA-SS
78-77-CA-SS 78-82-CA-SS
78-78-CA-SS 78-83-CA-SS
78-79-CA-SS 79-97-CA-SS
Decision No. 160

DECISION

These 10 appeals by the California Department of Benefit Payments (hereafter, California or State) are being considered together, by agreement of the parties, because they present common factual and legal questions. The Board considered these cases under the procedures at 45 CFR Part 16, in accordance with the State's request.

The case docketed as 79-97-CA-SS involves an appeal dated May 16, 1979, of a September 10, 1974 disallowance by the Administrator, Social and Rehabilitation Service, of $3,279,520 of Federal financial participation (FFP) claimed for administrative costs. The Board is deciding this appeal pursuant to an April 20, 1979 court order, effectuating a stipulation of the parties, in California v. Secretary of Health, Education, and Welfare, No. C-74-2647, United States District Court for the State of California. The other nine cases, docketed as 78-75-CA-SS through 78-83-CA-SS, involve requests for reconsideration of the July 31, 1978 decisions by the Acting Commissioner of Social Security affirming disallowances of a total of $5,006,214 FFP for administrative costs.

The dispute here concerns the Department of Health, Education, and Welfare (HEW, now HHS) Audit Agency findings that the State's method of allocating costs resulted in charges of unallowable food assistance administrative costs to federally aided public assistance programs under Titles I, IV, X, XIV, and XIX of the Social Security Act for audit periods ranging from January 1967 through June 1974.1/

1/ The Social Security Administration (the Agency) is representing the various constituent agencies of HHS which administer the public assistance programs under the titles at issue here.

For the reasons stated below, we conclude that these disallowances should be upheld. This decision is based on the submissions of the parties and the conference which the Board held on December 17, 1980.

Background

The State's Department of Benefit Payments (formerly Department of Social Services) which administered State and federally aided public assistance programs, also administered the United States Department of Agriculture (USDA) food assistance programs which were operated at the county level. USDA did not provide federal funds for the administrative costs of the food assistance programs during the periods at issue here. The USDA Food Stamp Program operated through various county welfare departments which were responsible for authorizing, handling, and issuing food coupons to public assistance and non-assistance households. Many of the counties contracted with banks and other fiscal agents to perform the functions involved in handling and issuing food coupons. The counties reported the bank and other fiscal agent charges on their expense report in the section for "Purchases of Services," under the caption, "All Other." The counties also participated in the USDA Food Surplus Distribution Program, and had the responsibility for storing, packaging, and distributing food to individuals whom the welfare department determined were eligible. The expenses for services and handling incident to obtaining surplus foods for distribution (principally, incoming freight charges) were reported in the "Operating Costs" section, under the caption, "All Other." See e.g., Audit Report No. 20144-09, pp. 10, 13.

Prior to 1968, California claimed FFP based on a "direct allocation" method whereby each item of expense was identified and directly allocated to the program for which it was incurred. A study of California's accounting methods, conducted by HEW in 1966, concluded the the direct allocation method was too complex. The study recommended, among other things, that the State adopt a "cost pool" method of claiming costs. In 1968 the State adopted a new accounting approach whereby the costs of administration for the county welfare department were placed in a cost pool and allocated to the federal and non-federal programs participating in the pool by use of apportionment formulas based on time and salary studies of the county welfare workers. Some of the administrative costs were still charged directly to the programs for which the costs were incurred.

HEW audits of the State's Expenditure Reports for county administrative costs concluded that the costs of issuing and handling food coupons and the costs of acquiring, storing, and distributing surplus food should have been allocated directly to the Food Stamp and Surplus Food Distribution Programs, because including them in the cost pool resulted in the allocation of these costs to the federally aided public assistance

programs. As a result, the Agency requested that California revise its cost allocation plan, return a total of $8,285,734, and review county records to identify unallowable food assistance costs not discovered by the auditors. See Audits Numbered: ACN 20144-09, ACN 50250-09, ACN 50262-09, ACN 50263-09, ACN 50264-09, ACN 50266-09, ACN 50267-09, ACN 50268-09, ACN 50271-09, ACN 50274-09. The State has since revised its cost plan to direct charge food assistance administrative costs.

Relevant Provisions

Handbook of Public Assistance Administration, (HPA), Part V, §4810:2/

Federal Financial Participation

For the purpose of this section, the term, public assistance recipients, means applicants for or recipients of assistance under the federally aided State public assistance programs, including medical assistance for the aged.

A. Federal financial participation is available for matching State and local welfare agency expenditures for the initial certification and recertification of households as eligible (1) to obtain coupon allotments under the food stamp program or (2) to receive foods under the direct distribution program of the Agriculture Marketing Service, when one or more members of the household are public assistance recipients.
B. Federal financial participation is not available for matching State or local welfare agency expenditures for the certification of households in which no members are public assistance recipients.
C. Federal financial participation is not available for matching the State and local welfare agency expenditures for costs incident to the acceptance, storage, protection, issuance of, and accountability for, food coupons; nor for the costs of storage, packaging, and distribution of foods under the surplus food program. (emphasis added)

2/ The Acting Commissioner of Social Security's disallowance determinations of July 31, 1978 include as "conclusions of law," that, although HPA provisions are not regulations, they have the force and effect of regulations, citing King v. Smith, 392 U.S. 309, 317 (1968). The State questioned the validity of the HPA in proceedings prior to the Acting Commissioner's decisions, but has not presented such arguments before the Board. See Tr., p. 90.

HPA, Part V, §4820:

> Cost Allocation Plan
>
> If the State agency and/or one or more local agencies makes expenditures of the kind described in V-4810, items A, B, and C, above, the cost allocation plan must indicate how such costs are to be handled in making the Federal claim... The cost allocation plan must be amended, if necessary, to give effect to this intent and to exclude from the Federal claim all costs identified under V-4810, items B and C.
> (emphasis added)

HPA Part V, §4031.1 (deleted and replaced by 45 CFR 205.150, February 27, 1971, 36 FR 3862):

> Direct charges shall be made for expenses of special projects that are not a cost of the administration of old-age assistance, aid to dependent children, or aid to the blind-- such as expenses incurred for...storage and distribution of commodities.
> (emphasis added)

Discussion

I. Whether the State's Method of Allocating Costs Resulted In Charging Unallowable Food Assistance Costs to Public Assistance Programs.

With the limited exception of certain costs to be discussed later, the State admits that the costs at issue were not eligible for FFP. See e.g., Application for Review in 79-97-CA-SS, (hereafter Application) Exhibit 1, p. 3, and Conference Transcript, (hereafter Tr.) p. 70.

The State contends, however, that it is incorrect to assume that the State claimed reimbursement for food program costs simply because those costs were included in the cost pool which was allocated in part to public assistance programs. Application, Exhibit 6, p. 9. The State explains that the concept of the cost pool method is to place all costs of a similar nature in a pool and select a base from which to develop a formula which would equitably distribute costs to the programs participating in the pool. According to the State, the food assistance costs can be placed in the pool of administrative costs because through the use of the apportionment formula based on county welfare worker salary and time studies, the costs at issue were charged, not to any federal public assistance program account but to a "county only programs"

account for which FFP was not claimed. The State maintains that the Agency auditors never challenged the use of the salary and time studies to fairly apportion the State's administrative costs.

The State claims that the food assistance costs could be included in the pool even though the time studies did not reflect the activities of the bank and fiscal agent employees because the costs of writing warrants for the Title IV-A program are of a similar nature and were included in the cost pool without objection by the Agency. Tr., pp. 19, 22. The State also argues that if it is theoretically wrong to apportion any costs attributable to purchased services, then all such services must be removed from cost pools and directly charged. State's post-conference brief, p. 16.

Further, the State claims that once costs are placed in the pool they lose their identity and should not be singled out for direct charging because they appear to be unallowable or directly allocable. The State asserts that the Agency can not remove from the cost pool those items which it determined could be identified as directly allocable to a program function in which there was no FFP, without also removing from the cost pool those items for which there was FFP. The State argues that by requiring the direct charging of these food assistance costs, the Agency is improperly treating some expenses as though the State was claiming under a direct allocation method, and other expenses under a cost pool accounting system, resulting in an unsound mixture of accounting methods. See Application, Exhibit 5, p. 22. In addition, the State claims that even if the Agency were correct in its contention that the apportionment formula is incorrect in this case, the remedy is wrong. The State argues that if the formula is wrong, then the Agency should point out the error in the formula and propose adjustments based on using a corrected formula.

The Agency argues that the costs at issue were disallowed because they should have been claimed as direct costs of the counties' food assistance programs. The Agency claims that including these food assistance costs in the pool which distributed administrative costs to public assistance programs by this formula resulted in unallowable charges to those programs. The Agency asserts that HPA §§ 4810 and 4820 prohibited claims for FFP for these costs, and that these costs were not allocable by means of the formula based on county employee time studies. In addition, the Agency asserts that HPA § 4031.1 required the State to direct charge the costs of storing and distributing food commodities.

The Agency argues that since the bulk of the unallowable food assistance costs were generated by employees of banks and institutions with whom the State had contracted to provide services under the food stamp program, a formula based on the time studies of welfare employees incorrectly apportioned the costs in the pool to the programs involved. Agency's Memorandum in Support of Disallowances (hereafter Agency Memorandum), p. 21.

The Agency argues, in addition, that the inclusion of these unallowable costs increased the total amount of the pool, and consequently, when the apportionment formula was applied, the charges to public assistance programs were proportionately increased. The Agency explains that it therefore removed these costs from the pool to be direct charged to the county so as to correctly reflect the amount of unallowable costs that were charged to the public assistance programs without disturbing the claims for other costs, as follows:

> We identified the amount of unallowable costs in the particular cost pool. We then computed the percentage of those unallowable costs to the total costs in the cost pool. We then applied that percentage to the total amount which had been allocated to the public assistance programs from the cost pool to arrive at the amount by which the public assistance programs had been improperly charged. Finally we determined the federal share of that amount by the use of ratios computed by the counties for claiming costs at 75 per cent and 50 per cent.

Agency Memorandum, Attachment C, pp. 3-4.

The Board concludes that the Agency was not unreasonable in requiring the State to eliminate from the pool costs which are unallowable to any federal program because the State has not shown that its method of allocating costs excluded the unallowable costs from claims for FFP.

It is a basic principle of grants law that to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the grant program, be allocable to that program, and conform to any limitation or exclusion set forth in federal laws or other governing limitations as to types or amounts of cost items. A cost is allocable to a particular cost objective to the extent of benefits received by such objective. See e.g. Office of Management and Budget (OMB) Circular No. A-87, Attachment A, Section C.1 and 2.

The HPA specifically requires that the State's cost allocation plans indicate how the unallowable food assistance costs are to be handled in making a federal claim, and directs that the plans be amended, if necessary, to insure that these costs are excluded from federal claims. See HPA §§ 4810, 4820.

While the State claims that its allocation formula "factored out" these unallowable costs and charged them to an account which does not receive federal funds, the State has not presented persuasive evidence to support this position. Since the HPA required the State to insure that no FFP was claimed for these unallowable costs, and there is no clear relationship between the county welfare employee time study and the costs of storing, issuing, distributing and accounting for food and food stamps, the State had the burden of showing that its method of allocation did not result in claims for FFP. The State has not shown how a method of allocation, based only on county employee salary and time studies, excluded the unallowable costs, such as bank charges and freight costs, from claims to the public assistance programs which participated in the pool.

Rather than explain how its allocation method excluded these charges from programs not benefitted by the costs, and from claims for FFP, the State relies on its argument that costs cannot be removed from the cost pool (and direct charged) without destroying the cost pool concept. This argument implies that all of the other administrative costs of the programs participating in the pool were charged through the cost pool. Such is not the case.

The State in Circular Letters instructing the counties on how to charge administrative expenses, required certain types of costs be directly charged rather than pooled, particularly where a higher rate of FFP was available for a cost. See e.g. Application, Exhibit 7D, Circular Letter No. 2272, pp. 9-10, 15, 19, 20, 22, 23, 25. In addition, the State's Circulars explain that there are two types of costs -- "[t]hose that can be segregated and allocated to program according to the regular cost accounting plan, and those of such a special nature that allocation is not practical and would result in program inequities or erroneous governmental participation." See Application, Exhibit 7B, Circular 2199, p. 1 and Exhibit 7D, Circular 2272, p. 4.

In addition, for those purchased service costs charged through the pool after the effective date of 45 CFR 205.150, as amended, on September 26, 1973, the regulation governing cost allocation specifically provides that purchased services should be excluded from cost allocation. See 38 FR 26804.

The State argues that, rather than requiring the direct charging of these costs, the Agency should point out an error in the formula and propose adjustments based on using a corrected formula. This argument ignores the fact that HPA §4031.1 required the direct charging of the costs of distributing the food commodities, and that the State's method of allocation recognizes that there are costs "of such a special nature that allocation is not practical and would result in program inequities or erroneous government participation." Since the Agency has explained how it removed the costs from the pool in a manner which did not disturb the claims for other costs in the pool, the Board concludes that the Agency's decision to require the State to direct charge unallowable food assistance costs is not unsound or inconsistent with the State's method of allocating costs. The State may be correct in its claim that the Title IV-A warrant writing or other costs of purchased services are also directly allocable; however, we do not here make a ruling with respect to costs which are not at issue before the Board. This decision does not preclude the exclusion from the pool, and direct charging, of those costs which the apportionment formula does not allocate to the proper programs.

II. Whether These Disallowances Constitute Retroactive Disapproval of the State's Cost Allocation Plan.

The State claims the costs at issue were claimed pursuant to an approved cost allocation plan and, therefore, the disallowances amount to a retroactive disapproval of the plan. According to the State, its new cost allocation plan was formalized in the form of instructions on claiming costs, in Circular Letters (Numbered 2199, 2272, 2236) sent to the counties on September 27, 1968, March 14, 1969, and August 15, 1969, respectively.

In support of its claim that the plan was approved, the State asserts that Agency and State representatives worked together closely to develop this cost allocation plan and the State received tacit, if not actual, approval of its method of allocating costs, because in the numerous communications with HEW with respect to the plan, the Agency never disapproved this method. The State further claims that the fiscal representative for HEW, Region IX, "was aware that food stamp handling and issuance costs and surplus food distribution costs were included in the cost pool. [We] specifically discussed including these costs in the cost pool. [He] either specifically or tacitly approved of these costs being included in the cost pool since there was an allocation base to distribute costs to programs." State's post-conference brief, p. 5. The State presents, as further evidence of approval, the fact that when the Regional Commissioner was sent copies of Circular Letters 2199 and 2272, he commented on several matters unrelated to these cases but did not question the inclusion of food stamp issuance costs in the pool, and that he did not respond when he was sent a copy of Circular 2328. The State claims the Circulars were sent to HEW for approval.

It is the State's position that once the plan was approved, the retroactive reduction of the grant award based on a determination that the plan is not acceptable is a clear violation of the Congressional mandate that HEW will participate financially in the costs incurred by a state in operation of federal programs in accordance with an approved State plan, citing the "Payments to the States" sections of Titles I, IV, X, XIV, and XIX of the Act, and 45 CFR 205.150. See Application, Exhibit 1, p. 7 and Exhibit 5, p. 18.

The Agency denies that it approved the Circulars for incorporation into the State's plan. The Agency explains that in 1966 it approved for incorporation into that State's plan Fiscal Manual Section F-860.50 (Submittal No. 712), which provided for the direct charging of the food assistance costs at issue. In addition, the Agency states that in April 1969, it approved Submittal No. 803 which amended certain provisions in the plan but did not alter the direct charging practice for the costs at issue.

The Agency asserts that the State never submitted the Circulars for approval as plan material to replace the previous provision for direct charging these costs. As evidence, the Agency submits letters dated October 7, 1968, March 18, 1969 and August 19, 1969 in which the State wrote: "The following which have been sent to you should be classified as information." The three Circulars at issue were included on the list of items "classified as information." Agency Memorandum, Attachment A, pp. 3-4.

The Agency asserts that since the Circular Letters were not submitted for approval as part of the State plan, the Agency had no duty to approve or reject them, and its comments were merely advisory. Further, the Agency argues that:

> [t]he State's intent to supersede the provisions of its approved State plan for the direct charging of food program costs by its new cost allocation method and to treat food program costs through pooling and allocation on the new time-study basis is so obscure in the Circular Letters, that the Regional Commissioner could not reasonably have been expected to comment on the treatment of food program costs. Under such circumstances the Regional Commissioner's comments cannot be viewed as in any sense a formal or informal approval of this revised treatment of food program costs.

Agency Memorandum, p. 10.

The Board concludes, based on the evidence in the record, that the State has not shown that the Agency approved the inclusion of unallowable food assistance costs in the pool for allocation. The State plan required the direct charging of the costs at issue; we conclude that the State did not receive actual or tacit approval for altering the plan based on the Agency's lack of comment on the inclusion of unallowable food costs in the pool and informal conversations with regional personnel. While the Agency was required by federal statute and regulations to make a determination when the State submitted a State plan for approval, the evidence in the record does not indicate that the State submitted the Circulars for incorporation into the State plan. The State has not shown that the Agency had an affirmative legal obligation to respond to Circular Letters sent to the Agency for information purposes.

Further, the State's argument that approval for allocating the food assistance administrative costs through the pool could be inferred because the Agency did not question the treatment of these costs, incorrectly implies that the Circulars clearly indicate that these costs would be allocated through the pool. We conclude that the Agency was not on notice of, and did not approve by silence, the State's alteration of its practice of direct charging these costs simply because they were not on a list of items excluded from the pool. Such a finding would be particularly unreasonable in light of the HPA provision requiring the State to identify how it will handle these types of food assistance costs. HPA § 4820.

The Agency cannot reasonably be required to operate under a system in which documents submitted for information (rather than for required approval) and informal discussions with Agency personnel would somehow bind the Agency to a course of action merely because the Agency did not formally or explicitly express disapproval of the course of action. There is no principle of law which would place the Agency at such an extreme and constant risk. It is unreasonable to impose on the Agency the burden of carefully scrutinizing all papers submitted by the State and others to determine whether some buried sentence might result in claims for otherwise clearly unallowable costs, and it is similarly unreasonable to suggest that substantial sums become obligated based on informal oral conversations. In that context, the Board finds that the State has presented no substantial evidence of actual or tacit approval by the Agency for including these unallowable costs in the pool.

III. Whether Costs Related to the Issuance of Authorizations to Purchase (ATPs) Food Stamps are Allowable Certification Costs.

The State argues that even if the Board upholds the determination that unallowable food assistance costs were allocated to the public assistance

programs through the cost pool, the costs related to issuing ATPs are allowable as certification costs for which FFP is available pursuant to HPA § 4810. An ATP is a form, issued monthly, which states the amount of food stamps a recipient is eligible to receive, and the amount the recipient must pay for them. The State's position is that ATPs are "a gray area ... in between the certification and ... the issuance ... part and parcel of both," but argues that ATPs are certification costs because a client is not eligible to receive food stamps until the client receives the ATP. Tr., pp. 75-76. In support, the State asserts that Agency does not cite any federal regulation which identifies the ATP process as an issuance cost, and notes that ATPs are treated as a part of the certification process in its State plan for county and administrative expenditures and in a federally approved State handbook. The State's Fiscal Manual Section 860.50 provides that the "certification process ceases after issuance of the certification and authorization to purchase food stamps." See e.g., Tr. pp. 72, 85, 95-96, and Agency Memorandum, Attachment A, p. 3.

The Agency admits that FFP is available for certification costs but argues that certification is limited to the process of determining an applicant's eligibility for the food stamp program. The Agency argues that after the determination is made that an applicant is eligible, the issuance process begins, and ATPs are an integral part of the issuance process because without them, recipients cannot purchase food stamps. Agency Memorandum, p. 29.

The Agency asserts that after a recipient is certified as eligible to receive food stamps, ATPs are issued each month to enable recipients to purchase the food coupons. Therefore, the Agency concludes that providing ATPs to recipients is a monthly issuance function which allows food stamps to be distributed in a convenient manner, rather than a function connected with certification. The Agency argues, "to accept the State's premise that the issuance of an ATP is part of the certification process ignores the reality that most ATPs are issued at a time other than the time of certification." Agency post-conference brief, pp. 3-4.

With respect to the provision in the State handbook which states that certification ceases after the issuance of ATPs, the Agency responds that "to the extent that the work required to prepare the ATP is incident to the determination of eligibility for public assistance, the language of the State Handbook is correct." The Agency explains that when the same worker who has determined public assistance eligibility prepares the ATP, the costs are incident to the determination process and eligible for FFP. The Agency maintains that any other interpretation would make the provision contrary to the HPA, and the

State's handbook is binding only to the extent that its provisions are not contrary to any federal law or regulations. Agency post-conference brief, pp. 3-6.

The Board upholds the disallowance of costs related to the issuance of ATPs based on a finding that they are not certification costs for which FFP is available. The HPA provides that FFP is available for the costs of certifying and recertifiying households as eligible to receive food stamps but specifies that FFP is not available for costs incident to the issuance of food stamps. HPA §4810. We find that the ATP costs at issue are costs incident to the issuance of food stamps rather than costs of certification.

The State relies on the fact that a recipient cannot receive food coupons without an ATP as evidence that it is part of the certification process, but that fact can also serve as evidence that ATPs are incident to the issuance of food stamps. The State admits that the recipient is probably notified of eligibility to receive food stamps by some other form prior to the issuance of ATPs. See Tr. pp. 75-76.

Rather than being a part of the determination of eligibility, the ATPs are issued to eligible recipients to show the face value of the coupon allotment the recipient is entitled to receive on presentation of the document and the amount to be paid for such allotment. See USDA regulations at 7 CFR 270.2(f) and Agency's post-conference brief, pp. 3-5. In addition, the Agency persuasively argues that the issuance of ATPs is not connected to the process of determining eligibility to receive coupons since ATPs are issued to recipients each month and recertification occurs only every six months; the State has not argued that the certification process is repeated each month.

The State reliance on the provision in its handbook which states that the "certification process ceases after the issuance of the certification and authorization to purchase food stamps" does not necessarily support its claim that ATPs are part of the certification process. The provision read literally is inconsistent on its face. First, it provides that certification ceases after certification and some other activity. In addition, it provides that the certification process ceases after the issuance of the certification and authorization to purchase. To interpret this section as tying certification with the issuance of ATPs would require a determination that the certification process never ceases, since the ATPs are issued each month.

Given the incongruities of the State's handbook provision, the Board finds that on balance, the Agency's interepretation that the handbook

provision applies only to situations where ATPs are prepared coincidently with issuance of the certification is more reasonable.

Conclusion

For the reasons stated above, these appeals are denied.

The State has claimed that P.L. 95-291 applies to a portion of the costs disallowed here. The Act authorizes an appropriation to reimburse certain expenditures for social services (and related administrative costs) provided by the states under an approved State plan, prior to October 1, 1975, under Titles I, IV-A, VI, X, XIV, and XVI of the Social Security Act, and precludes recovery of any amount paid to a State prior to April 1, 1977 for such social services. The Agency has agreed to review the disallowances to determine what amounts, if any, represent social services and adjust the disallowances to reflect that amount. See Agency Memorandum, p. 33. If the State does not accept the Agency's determination with respect to the amount of social service costs involved, the State may appeal such determination to the Board.

/s/ Cecilia Sparks Ford

/s/ Donald F. Garrett

/s/ Norval D. (John) Settle, Panel Chair