

DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

Subject: Oregon State-wide Cost Allocation Plan
Docket No. 75-7
Decision No. 22

DATE: June 25, 1976

DECISION

Costs of support services provided to State grantee or contractor agencies by other State agencies may be allowable as costs under federal grants or contracts provided that a State-wide Cost Allocation Plan (SWCAP) has been submitted and approved by the Department of Health, Education, and Welfare which acts as the lead agency for this purpose for all federal grant-making agencies pursuant to OMB Circular A-87 (now FMC 74-4, 34 CFR Part 255).

Oregon's SWCAP for fiscal years 1970 - 1973 was approved by HEW. Its proposed SWCAP for 1974 was questioned because of three principal inclusions which had not been questioned in the earlier period. A determination disapproving the SWCAP was upheld by the Regional Director. Oregon appealed. The three items at issue are rental rates for space in state-owned buildings, costs for data processing services and costs for legal services.

We sustain the Regional Director because the requirements of A-87 have not been met.

Rental of State-Owned Buildings

The HEW audit found that approximately \$2.3 million out of \$6.5 million to be charged for rental of space in State-owned buildings would not be acceptable under the provisions of A-87. These included costs of construction, interest and space occupied by the State Legislature and Supreme Court. Over \$400,000 of costs reflecting the cost effect of correcting the rental base are conceded by the State, so that approximately \$1.9 million is at issue.

The State's statutory method of computing rental rates seeks to produce sufficient funds to pay for additional sites and buildings and to recover the interest on indebtedness

incurred for such purposes. The audit challenged the rates as including in those respects unallowable costs. We reach the same result on different grounds. The State does not appear to have claimed these items as costs except perhaps by inference in argument. It has instead adopted an approach of setting rates so as to generate funds for future activities. In effect, it looks to the future rather than to the past and provides for replacement at current cost rather than historical cost.

It claims that the rates so set are consistently lower than comparable market rates, and this appears to be accepted as true.

It asserts that its treatment is reasonable, logical, prudent, consistent with other prior plans which had been approved, satisfies the overall purpose of A-87, and provides a fair allocation between federally assisted programs and others. All this may be accepted as true and may warrant either reexamination of A-87 or consideration of a deviation from A-87.

It asserts that a rental rate accounting rate nearly identical with its own has been established for Federal use under 40 U.S.C. 490 and is not considered to involve any increment above cost. The asserted parallelism does not appear to be challenged, although an important distinction may be noted. The federal system is wholly internal and is a reasonable and effective system for planning and making adjustments within the federal government. It affects no one outside the government. The State system may be equally effective as an internal device, but it also affects substantial payments to be made to the State by the federal government. For that purpose it is unacceptable.

It appears to be undisputed that the State's computation does not establish those costs defined as allowable by A-87 and the Regional Director acted within his authority in rejecting the State plan on that ground.

It appears possible that properly computed the State may be entitled to more than the Audit Report recommended, and that a proper computation would come close to the rates

the State reached by its own method. For example, this may be the result if the State claimed depreciation. If it lacks adequate depreciation records, it may be permitted under A-87 B.11.b. to substitute reasonable estimates. Some compromise with the Regional Office might well have been worked out. The State has however apparently elected not to seek accommodation.

Computer Rates

The audit also questioned billing rates for data processing services provided by the Executive Department. Of \$3.4 million to be recovered through these billing rates, about \$1.6 million were questioned as representing cost of new equipment and interest. The HEW auditors agreed that the State was entitled to a use allowance of over \$300,000, leaving about \$1.3 million at issue. More generally however, the auditors also questioned the entire amount for lack of documentation to show how the rates were computed. Because of the lack of documentation, which the State has not challenged, we find against the State on the computer rate issue. The State may of course resubmit to the Regional Office its plan and properly document it. To avoid misunderstanding we comment on certain other issues but do not decide them.

The State asserts without contradiction that purchase rather than lease has resulted in savings of over 25% in costs. It contends that the rejection of its costing system amounts to a penalty for saving the federal taxpayers money. This contention has substantial merit. The rule against allowing interest (A-87 D.7) as it is often interpreted operates to encourage rental of equipment where leasing-with-option to purchase or installment purchase is more economical. The United States finds purchase, installment purchase or lease-with-option basis more beneficial than straight rental basis for its own acquisitions of computer equipment but pushes grantees into the less beneficial system of straight rental. It is neither possible nor necessary, however, on this state of the record that we pass on the question whether the computer rates in this case may be allowed under a proper construction of A-87. The State has conceded that the requirements of A-87 have not been met and has not challenged the auditors' finding that documentation showing how the rates were computed was lacking. Only if the plan is properly documented and submitted to the Regional Office can the issue be properly determined by the Regional Director. (See University of California at San Diego, Docket No. 23, Decision No. 13, esp. at pp. 3-4, on the cost principles applicable to computer acquisitions).

The Regional Office also took issue with the spreading of costs over the payment period rather than the useful life of the equipment. The payment period (in this case, 5 years) however, is substantially the useful life of the equipment (usually taken at 5 to 8 years; the Audit Report in this case refers to IRS recognition of an amortization period of 5 to 7 years; GAO Report B-115369 (July 24, 1975) p. 18 cited in San Diego above at p. 4 refers to a useful life of at least 5 years).

The State is also adversely affected by the employment of a use allowance instead of a depreciation. It asserts that it lacks depreciation records and that that lack is attributable in part to reliance on prior HEW approvals which did not require maintaining depreciation records. The Regional Director responds that the State had been warned that earlier approvals were provisional and should now be keeping appropriate records.

It may well be that a rate closer to the State's claim could have been achieved if the State had responded to invitations to negotiate, but again, it has apparently declined to seek adjustment by negotiation.

The Board does not wish to be utilized as a recourse for avoiding the normal processes of negotiation which are available, encouraged by the Board and generally more productive for all parties than confrontation.

Legal Services

The State claimed inclusion of costs for the services of its Attorney General's Office. Some of these costs are properly allowable as the Regional Office recognizes. Others are excluded by A-87. Section B-16 of A-87 Attachment B excludes legal services furnished by the chief legal officer solely in discharge of his general responsibilities as legal officer. Legal expenses for the prosecution of claims against the Federal Government are also excluded.

To the extent that there is a disagreement about specific dollar amounts involved, the State was advised that the amount of this item was negotiable, but apparently specifically refused to negotiate.

General Policy Considerations

In an Order directed to the State, the record was summarized as showing no denial by the State that its plan does not conform, in the respects identified by the Audit Report, to specific requirements of such plans set forth in A-87, OASC-6 and Chapter 1-77 (now 6-10) of the HEW Grants Administration Manual. The Order called on the State to correct any inaccuracy in our summary. In its response, the State did not challenge this view of the record.

In its thoughtful and persuasive briefing, the State urges that the specific provisions of A-87 operate, on the facts involved, to penalize reasonable and beneficial procedures. This may well warrant reconsideration of some aspects of A-87. In particular, the issuance of the Cost Accounting Standards Board's No. 414 (4 CFR Part 414; 41 FR 22241, June 2, 1976) reflects a reexamination of the concepts of cost and profit and a reorientation of approach to capital acquisition costs which may be appropriately taken into account in any reconsideration of A-87, A-21 and similar sets of cost principles.

All of these considerations might well have influenced the discretion the Regional Director could exercise. We need not determine whether we would have made the same discretionary judgments. It is possible that the Regional Director had more room for discretion than he recognized. Nevertheless, since his decision is reasonable and in accordance with the rules explicitly applicable, and since the State has declined opportunities to negotiate adjustments with the Regional Office, we sustain the Regional Director's decision.

The State has repeatedly requested a formal hearing with record and examination and cross-examination of witnesses. It has not, however, after specific invitation to do so, identified any material issue of fact the resolution of which would be materially assisted by such hearing. (45 CFR §16.8 (b)(2) and 16.60(c)).

The State may resubmit to the Regional Office a cost allocation plan in accordance with A-87 and will have an opportunity there to support the plan under A-87 standards and to negotiate negotiable items.

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The State has not complied with the requirements of
A-87. The appeal is denied.

/s/ Thomas Malone

/s/ Francis D. DeGeorge

/s/ Malcolm S. Mason, Panel Chairman