

**Department of Health and Human Services  
DEPARTMENTAL APPEALS BOARD  
Appellate Division**

Ohio Department of Administrative Services  
Docket No. A-11-59  
Decision No. 2423  
December 2, 2011

**DECISION**

The Ohio Department of Administrative Services (ODAS) appealed in part the March 2, 2011 determination of the Division of Cost Allocation (DCA) requiring ODAS to refund \$7,022,106. DCA found that this amount represented the federal share of excess reserves in ODAS's Office of Information Technology (OIT) internal service fund as of June 30, 2008, plus imputed interest from July 1, 2005 through June 30, 2008. ODAS appealed DCA's determination with respect to \$2,795,868, which DCA found was the federal share of excess reserves in the internal service fund for acquisition management, plus imputed interest. During the proceedings before the Board, DCA revised its determination. DCA found that the amount allocated to federal awards from the acquisition management cost pool was overstated by \$3,604,301 because ODAS failed to treat fees that vendors under contract with ODAS were obligated to pay as "applicable credits." DCA also found that adjusting for the applicable credits would reduce the federal share of excess reserves to \$197,791 and that the total amount to be refunded, including imputed interest, was \$3,815,336.

ODAS maintains that it has accounted for all of the excess reserves for the acquisition management internal services fund and that the vendor fees were properly accounted for under the approved cost allocation plan as revenues reducing the allocated costs for acquisition management services.

For the reasons discussed in detail below, we conclude that no excess reserves are required to be refunded and that ODAS was not required to account for vendor fees as DCA argued in its revised determination. Accordingly, we reverse DCA's determination that ODAS is required to refund \$3,815,336.

**Regulatory background**

The allowability of costs claimed by state governments under federal grants is governed by Office of Management and Budget (OMB) Circular A-87, now codified at 2 C.F.R. Part 225. *See* 45 C.F.R. § 92.22(b). The "total cost" of a grant program is comprised of

the program's allowable direct and indirect costs, less "applicable credits." 2 C.F.R. Part 225, App. A, ¶ D.1. Paragraph C.4.a. of Appendix A states:

Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

To be allowable, a cost must, among other things, be allocable to the award. *Id.*, ¶ C.1. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received. *Id.* at ¶ C.3.a.

Central service costs are the costs of services provided by a state on a centralized basis to its various departments and agencies, which in turn may receive federal funding in those costs to the extent they administer federally-funded programs. To ensure that central service costs are identified and assigned to benefitting federal programs and activities on a reasonable and consistent basis, Part 225 establishes a process for submission and approval of a central service cost allocation plan, also referred to as a state-wide cost allocation plan (SWCAP). 2 C.F.R. Part 225, App. C, ¶ A.1. The SWCAP identifies and accumulates the central service costs, and then allocates or bills them to the user agencies. *Id.*, App. A, ¶ B.4. For each year that a state claims central service costs, it must submit a SWCAP for review, negotiation, and approval by the cognizant federal agency. *Id.*, App. C, ¶ D.1. (HHS is the cognizant federal agency for Ohio, and DCA is the HHS component responsible for SWCAPs.)

Costs of central services that are billed to benefitted agencies and/or programs on an individual fee-for-service or similar basis are called "billed central services." 2 C.F.R. Part 225, App. C, ¶ B.1, B.2. The revenues that a state agency receives from other state agencies for billed central services may be accounted for through an "internal service fund" (ISF), which the state uses to finance those services. Because ISFs are typically funded through periodic billing cycles, charges by an ISF activity to provide for the establishment and maintenance of a reasonable level of working capital reserve are allowable since this enables the ISF to pay expenses as they arise. Except in exceptional cases, a working capital reserve as part of retained earnings is considered reasonable if it does not exceed 60 days cash expenses for normal operating purposes. *Id.*, App. C, ¶ G.2. Amounts in excess of the working capital reserve are considered excess reserves for

which adjustments must be made through one of the following methods: a cash refund to the federal government for the federal share of the adjustment, credits to the amounts charged to the individual programs, adjustments to future billing rates, or adjustments to allocated central service costs. *Id.*, ¶ G.4.

Each billed central service activity must separately account for all revenues (including imputed revenues) generated by the service, expenses incurred to furnish the service, and profit/loss. 2 C.F.R. Part 225, App. C, ¶ G.1. With respect to billing rates, 2 C.F.R. Part 225 provides:

Adjustments of billed central services. Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs.

2 C.F.R. Part 225, App. C, ¶ G.4. HHS's 1997 "Implementation Guide for Office of Management and Budget Circular A-87," known as ASMB C-10, states that a "reconciliation schedule must be completed for all billed central services, including internal service funds[.]" DCA Ex. 1, at 48. ASMB-10 further states:

For those funds which utilize multiple billing rates . . . a reconciliation schedule may be required for **each** billing rate. An overall/average fund balance may not be appropriate, because excess charges may occur in one billed service but undercharges may occur in other billed services. In addition, various users do not utilize each/all billed services to the same extent.

*Id.* (emphasis in original).

### **Factual background**

The following facts are alleged by ODAS and/or appear from the record. None are disputed by DCA. For each of the fiscal years in question, ODAS's approved SWCAP described the nature and extent of the acquisition management services at issue and the method for allocating the costs of the services through billing as follows:

The office has responsibility for carrying out OIT [Office of Information Technology] statutory authority for stewardship of the procurement of information technology (IT) systems and services across state government. The division's responsibilities include management of the state's State Term Schedules, release and permit operations, and competitive sealed bid operations with regard to IT.

On behalf of the state, Acquisition Management develops, distributes and evaluates bid documents and proposals, **aggressively negotiates competitive pricing and terms leveraging the state's combined buying power**, and manages the state's procurement website . . . . Costs of this function represent preapproval services for equipment acquisitions.

\* \* \* \* \*

The **costs for this office are reallocated** to benefitting departments and/or agencies according to the total dollar amount of equipment and contracts approved **in the form of the Acquisition Management Assessment**. The procedure provides for an appropriate allocation of **all cost center charges**.

ODAS Ex. A at A-1 – A-4 (emphasis added). The SWCAP thus provides for billing benefitting state agencies for the cost of OIT's acquisition management services through an Acquisition Management Assessment (AMA). The AMA rate was the ratio (expressed as a percentage) of the costs in the acquisition management "Net Cost Pool" divided by the total dollar amount of IT purchases (i.e., equipment and contracts) made on behalf of state agencies (.75% in FY 2005, .50% in FY 2006, and .60% in FYs 2007 and 2008). This rate was then applied to the total dollar amount of each state agency's IT purchases to determine the billing amount (i.e., the AMA) for that agency. ODAS Br. at 3-4, 9.

To determine the Net Cost Pool, the SWCAP indicated that ODAS first totaled the costs in four categories and then made certain upward adjustments not relevant here. ODAS Br. at 3; ODAS Ex. D at D-1, D-2, D-5, D-7 (budget rate sheets). ODAS then made downward adjustments for "Interest Revenue," "State Term Contract Fee Income," and "SWCAP fund balance." ODAS Ex. D at D-1, D-2, D-5, D-7. The "SWCAP fund balance" is the excess reserve amount from the prior fiscal year. ODAS Br. at 4. "State Term Contract Fee Income" refers to fees required to be paid by certain vendors who entered into state term contracts with ODAS pursuant to the following contract term, titled "Contractor's Revenue Share":

The Contractor must pay the State a share of the sales transacted under this Contract. . . . The revenue share that the Contractor must pay equals .0075 of the total quarterly sales reported. The revenue share is included in the prices reflected on Exhibit I and reflected in the total amount charged to ordering activities, and the Contractor may not add a surcharge to orders under this Contract to cover the cost of the revenue share.

DCA Ex. 2, at 11. The vendors were also required to certify that state agencies would be charged either the same prices offered to the U.S. government under federal General Services Administration programs or the “best price at which the Contractor has offered each product and service to its most favored customers[.]” *Id.* at 2.

ODAS’s accounting system separately identified the costs and revenues of several “responsibility cost centers” (RCs) within the acquisition management cost pool. ODAS Br. at 5; ODAS Ex. B. In fiscal year 2005, there were two RCs. One of the RCs was thereafter split into two RCs. *See* ODAS Br. at 2-3, 8. The RCs are identified by number on the approved SWCAP for each fiscal year. ODAS Ex. A at A-1 – A-4. In fiscal years 2006-2008, the three RCs were:

RC3200 – Acquisition Management: “develops, distributes and evaluates bid documents and proposals prior to the approval of the OIT Director. . . ., negotiates competitive pricing and terms, and manages the State’s procurement website which serves as a single point of interface for all vendors doing business with the State”;

RC3210 – Acquisition Standards: “develops statewide information technology standards for implementation into the State’s procurement contracts, designs enterprise wide information technology architecture and advises agencies on implementation of large scale procurements” and

RC 3250 – Contract Management: “manages the State’s information technology (IT) state term schedules, release and permit operations, and competitive sealed bid operations.”

ODAS Br. at 2.

On an annual basis, ODAS prepared a reconciliation of the costs and revenues of its acquisition management cost pool. For fiscal years 2006-2008 (but not fiscal year 2005), the reconciliation contained separate excess reserve pages for each of the three RCs. ODAS Br. at 7; ODAS Ex. I at I-5. In each of these three years, there was a positive excess reserve amount in RC3200 and a negative reserve amount in the other two RCs. In fiscal years 2005 – 2007, ODAS showed all of the vendor fees as revenue to RC3200 while in fiscal year 2008, ODAS showed part of the vendor fees as revenue to RC3200 and part of the vendor fees as revenue to RC3250. ODAS Br. at 4; ODAS Ex. F-1. On the budget rate sheets used to develop the AMA rate, however, the vendor fees were shown as a single revenue amount netted against the total cost pool.

In 2011, ODAS submitted to DCA a revised reconciliation of retained earnings for each of fiscal years 2006 - 2008 which combined revenues and costs for all RCs. ODAS Br. at 7; ODAS Ex. E at E-13, E-24 and E-47. Each revised reconciliation contains a column

headed “Acquisition Management (Total)” under which there is an “Excess Reserves” amount calculated by subtracting from the positive amount in RC3200 the negative amounts in the other two RCs. The record does not contain any contemporaneous combined reconciliation sheets for the total cost pool (as opposed to the component RCs).

## Analysis

### 1. Excess reserves

DCA found that the acquisition management internal services fund contained excess reserves (i.e., more than a reasonable working capital reserve). Specifically, DCA determined that there were excess reserves equal to the total of the excess reserve amounts for RC3200 shown on ODAS’s annual reconciliations of the costs and revenues for this RC.

ODAS takes the position that DCA’s calculation is incorrect because it does not “recognize RC 3210 and RC 3250 as part of the Acquisition Management cost pool.” ODAS Br. at 7. According to ODAS, the breakdown of the acquisition management cost pool into RCs merely provides “additional detailed accounting of the types of services being provided under this cost pool.” *Id.* at 3; *see also id.* at 8, 10. ODAS asserts that “[r]evenues charged for the Acquisition Management functions are set to recover the costs of the functions of all three RCs under the Acquisition Management cost pool **as a single rate.**” ODAS Br. at 3 (emphasis added). ODAS argues all of the RCs should therefore be combined as shown on its revised reconciliations and that it has already accounted for the excess reserve amounts shown there.

We conclude that the record supports ODAS’s position. ASMB-10, quoted above, interprets the applicable regulations to allow the use of an overall/average fund balance unless there is more than one billing rate and the circumstances make it inappropriate to use an overall/average fund balance. Only one method – the AMA – is identified in the approved SWCAP for billing state agencies for the OIT services whose costs are included in the acquisition management cost pool. This method did not change during the years in question even though the SWCAP identified a change in the number of RCs.\*

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\* DCA argues that the vendor fee “has a billing rate” in the form of the .75% remittance from contract purchases which is “separate and apart from the [AMA rate].” DCA Br. at 17. It is not clear what DCA means by this since the vendor fees were collected from contractors, not billed to the state agencies receiving IT services.

Moreover, the fact that a combined reconciliation for three of the four fiscal years at issue was not provided to DCA on a contemporaneous basis is not dispositive. Documentation submitted by ODAS shows that the AMA rate was calculated from the costs and revenues for all of the RCs and was used to allocate acquisition management services in all of the RCs. Specifically, the subtotal of costs in the acquisition management cost pool (before application of the upward adjustments) for each of fiscal years 2006, 2007 and 2008 as shown on the budget rate sheets is roughly equal to the total of the allowable costs shown in ODAS Exhibit C for RCs 3200, 3210 and 3250. This result would not occur if only the costs from a single RC were being included in development of the AMA rate.

Thus, simply because ODAS's accounting system identified two and later three RCs within the acquisition management cost pool does not mean that ODAS should have disregarded the negative excess reserves in certain of these RCs in determining the amount of excess reserves in the acquisition management internal services fund.

Contrary to what DCA argues, moreover, *New Mexico General Services Dept.*, DAB No. 2083 (2007), does not support its position. In that decision, the Board concluded that New Mexico had not shown that it was appropriate to offset excess reserves in an ISF computer services sub-fund by undercharges for other types of services and for other billing periods. DAB No. 2083, at 1; *see also New Mexico General Services Dept.*, DAB No. 1876, at 9 (2003) (holding DCA need not credit "unbilled costs in different internal services rates categories" against admitted overcharges in others). ODAS does not argue for an offset here, but rather argues that its single billing rate for acquisition management services did not result in an excess reserve in the first instance.

Accordingly, we conclude that ODAS properly calculated the amount of excess reserves in its acquisition management internal services fund based on the net excess reserve amount for all the RCs considered together. Since ODAS accounted for this amount in each fiscal year by carrying it forward to the next fiscal year as permitted by the applicable cost principles, no cash refund is required.

## 2. Vendor fees

In its response to the appeal, DCA took the position that the vendor fees should have been treated as applicable credits to federal grants making contract purchases instead of as revenue that was deducted from the acquisition management cost pool used to calculate the AMA rate. According to DCA, the vendor fee is a "rebate" within the meaning of 2 C.F.R. Part 225, App. A, ¶ D.1. DCA Br. at 9, 12. DCA cites Board decisions indicating that the question of whether funds a state receives are applicable credits turns on "whether there is a direct relationship or nexus between the questioned receipt and the federally-funded program."

*Id.* at 13, citing cases. DCA specifically relies on *Michigan Dept. of Mgt. and Budget*, DAB No. 1994 (2005), as being “nearly identical.” *Id.* DCA argues in addition that the vendor fees were “unrelated to the cost of providing any service.” *Id.* at 15. According to DCA, this is shown by the fact that ODAS reported the vendor fees as revenue to different RCs in different years as well as the fact that the RC to which the vendor fees were attributed in fiscal years 2005-2007 ran a large surplus. *Id.*

We conclude that ODAS could reasonably treat the vendor fees as revenue to be credited against the cost of acquisition management services in the numerator of the ratio that was the AMA rate rather than as applicable credits which would reduce the costs of the IT contracts in the denominator of the ratio. This treatment is consistent with the methodology set out in the SWCAP which DCA approved. While a payment of vendor fees based on a percentage of contract costs may properly be treated a rebate and hence a credit applicable to the contract costs, DCA has not shown that the alternative treatment used here was unreasonable under the circumstances of this particular case, for the following reasons.

First, ODAS justifies its treatment of vendor fees as revenues on the ground that there is a direct relationship between the percentage of contract costs represented by vendor fees received in a fiscal year and the cost of acquisition management services for that year. Specifically, ODAS asserts that the .75% rate for vendor fees “was calculated based on the actual costs associated with managing” the state term contracts. ODAS Reply Br. at 3. DCA’s assertion that there was no relationship between the vendor fees and the acquisition management services is based solely on its position, which we rejected above, that each RC should be considered separately in developing the AMA rate. Thus, on the record before us, we see no valid reason to conclude that the vendor fees were not reasonably treated as applicable to the costs in the acquisition management services cost pool.

Second, there is no basis in the record for concluding that ODAS’s treatment of the vendor fees as revenues resulted in inequitable treatment of federal and non-federal programs, i.e., in federal programs paying more for acquisition management services than their fair share of the costs of these services. When the vendor fees are used to reduce the AMA rate charged to state agencies for acquisition management services, as ODAS did, all programs—whether or not they are federally funded—benefit from the vendor fees. Attributing the vendor fee payment to reducing the costs of individual contracts might well result in a different allocation, which might, in any given year, generate more or less benefit to federal grants. DCA does not allege any reason to conclude, however, that ODAS’s methodology was systematically skewed in favor of non-federal programs.



Third, while DCA claims that the documentation submitted by ODAS prior to this appeal did not separately identify the vendor fees as a source of revenue (*see* DCA Br. at 7-8), DCA could have asked ODAS to break down the revenue sources before it approved the SWCAP for each fiscal year. Moreover, DCA does not dispute the allegation of ODAS's internal audit manager from 1998 to 2008 that, during the negotiation of ODAS's fiscal year 2002 SWCAP, he suggested that vendor fees be reported as other miscellaneous revenue and that the DCA negotiator "agreed that this additional revenue should reduce the total cost of the function in calculating our procurement rate." Affidavit of Milagros T. Garcia, ODAS Ex. L at L-1. Thus, DCA should have known when it approved the SWCAPs that vendor fees would be treated as revenue reducing the acquisition management costs used in calculating the AMA rate.

Fourth, contrary to what DCA alleges, the situation in this case is distinguishable from that presented in *Michigan*, in which the Board held that the touchstone of an applicable credit is the "receipt of monies (or reductions of expenditures) by a state related to its federally funded program which, if unaccounted for in the program, would result in a savings or gain to the state alone." *Michigan* at 9, quoting *Oregon Dept. of Human Resources*, DAB No. 1298, at 10 (1992). Michigan agencies used a statewide contract with an office supply company, including for purchases under federal grants. The company was required to remit a percentage to the Michigan Department of Management and Budget (MDMB) for each sale. While MDMB claimed that the remittances were used to pay for central service costs, it did not "adjust[] downward the costs allocated to federal awards . . . under its SWCAPs to account for costs covered by the revenues" from the remittances. *Michigan* at 12. Since the remittances benefitted only the state in that federal grants bore the federal share of the full purchase prices without receiving any share of the remittances, the Board rejected MDMB's argument that it should be permitted to retain the remittances as part of its ISF. By contrast, ODAS's billing rate was developed from costs of acquisition management services reduced by the vendor fees. ODAS thus did what the Board said MDMB failed to do.

We note further that the alternative calculations accompanying DCA's response brief do not provide a basis for us to infer that failure to treat the vendor fees as credits to the contracts resulted in an inequity to the federal government in the allocation of acquisition management costs. In calculating that the excess reserve in the ISF was \$197,791, DCA simply reduced the excess reserve total for each year from fiscal year 2005 through fiscal year 2008 by the vendor fee revenue for that year shown on ODAS documents, and reduced the amount of the fund balance on June 30, 2004 based on an estimate of the amount of vendor fees for previous years. *See* DCA Br. at 10-12, citing DCA Ex. 5. DCA did not show, however, that it calculated what ODAS could have billed for acquisition management services if it had treated the vendor fees as applicable to the contract costs rather than to the acquisition management costs. This treatment would have resulted in different AMA rates and billing revenues in each year because the unreduced acquisition management costs would be higher than the amounts ODAS used

revised disallowance amount also assumes that the federal government was charged contract costs that included the vendors' fees, but there is no evidence DCA actually determined what prices were charged to federal programs. Instead, DCA simply applied federal participation percentages for each year to the total vendor fee amounts, including the estimate from years prior to FY 2005. Thus, even though DCA's revised calculations show over \$3 million as the amount due to the federal government, they do not provide a basis from which we can infer that ODAS's treatment of the vendor fees resulted in allocating to the federal government more than its fair share of acquisition management costs.

Accordingly, we conclude that, even if DCA could reasonably require ODAS to use a different method for distributing the benefit of the vendor fees on a prospective basis, it is not reasonable under the circumstances of this case to require a retrospective change.

### **Conclusion**

For the foregoing reasons, we conclude that ODAS properly accounted for all excess reserves and treated vendor fees as revenues in calculating the billing rate for acquisition management services for the years in question. Accordingly, we reverse DCA's determination requiring repayment of \$3,815,336 .

\_\_\_\_\_/s/  
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\_\_\_\_\_/s/  
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\_\_\_\_\_/s/  
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