

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

Missouri Department of Social Services
Docket No. A-15-80
Decision No. 2681
March 18, 2016

DECISION

The Missouri Department of Social Services (Missouri) appeals a \$76,702 disallowance by the Administration for Children and Families (ACF) arising from Missouri's payments from the State to a contractor for recruiting and training foster families, referred to as "resource development," as part of the state's title IV-E foster care program. ACF argued that the payments made under the fixed fee rate exceeded the contractor's actual costs and were therefore not allowable.

As explained below, we uphold the disallowance in part and reverse in part.

Legal, factual and procedural background

1. Administrative costs in the Title IV-E program

Title IV-E of the Social Security Act (Act), codified at 42 U.S.C. § 670 et seq., primarily provides for federal financial participation (FFP) in income maintenance payments made by a state for certain foster care children. The Board has long recognized that IV-E's role in providing funding for administrative activities associated with child welfare is "limited." *Mo. Dep't of Soc. Servs.*, DAB No. 1783, at 3 (2001). Even categories of administrative activities that may be permissible to charge to IV-E may only be claimed when they are "directly related" to administering the IV-E foster care program and are not claimable under any other federal program. *Id.* at 4, citing 45 C.F.R. § 1356.60(c); *see also Ohio Dep't of Job & Family Servs.*, DAB No. 2643, at 3 (2015). Allowable administrative costs under title IV-E must be incurred under an approved IV-E state plan and may include service referrals, child placement, case plan development and case reviews, foster home recruitment and licensing, and a proportionate share of related agency overhead to the extent those benefit the IV-E program. 45 C.F.R. § 1356.60(c) (2); DAB No. 2643, at 3. An enhanced rate of FFP (75%) is available for certain costs of title IV-E training for current or prospective state agency employees, current or prospective foster and adoptive parents, and members of certain child care institutions. 45 C.F.R. § 1356.60(b)(1).

The basic cost principles applicable to grants to states at the relevant time came from Office of Management and Budget Circular A-87, codified at 2 C.F.R. Part 225.¹ The circular laid out general principles for determining “allowable costs” — that is, costs eligible for funding under federal grants, contracts, and other awards. 2 C.F.R. Part 225, App. A, ¶ A.1. Under those cost principles, a cost is allowable (i.e., eligible for funding) under a federal assistance program only if it is, among other things, “allocable” to that program. *Id.*, App. A, ¶ C.1.b. “A cost is allocable to a particular cost objective” — a cost objective is a function, organization, or activity for which costs are incurred — “if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.” *Id.*, App. A, ¶¶ C.3.a., B.11. When a state incurs costs that support or benefit more than one public assistance program, the costs thus generally must be allocated to each program in proportion to the benefits that each derives from the activity that generated the costs. *Minn. Dep’t of Human Servs.*, DAB No. 1869, at 4-5 (2003).

2. Missouri’s Foster Care Services Contracts

Missouri contracted through a competitive bidding process in 2008 with foster care case management (FCCM) contractors to provide certain services related to its foster care program for the ensuing three years. Relevant excerpts from the request for proposals (RFP) are in the record and the terms of the resulting contract with one successful bidder are central to understanding the dispute before us. MO Exs. 1 and 2.

The bidders were asked to break out rates for four activities as part of a “base” payment: (1) case management, (2) resource development, (3) crisis treatment/special expenses, and (4) administration.² MO Br. at 3. Bidders were required to submit a “firm, fixed price” per case, per month (PCPM), based on the range of numbers of cases they

¹ In 2013, OMB consolidated the content of OMB Circular A-87 and eight other OMB circulars into one streamlined set of uniform administrative requirements, cost principles, and audit requirements for federal awards, currently published in 2 C.F.R. Part 200. 78 Fed. Reg. 78,590 (Dec. 26, 2013); *see also* 79 Fed. Reg. 75,871, 75,875 (Dec. 19, 2014) (promulgating regulations in 45 C.F.R. Part 75 which make the cost principles and other requirements published in 2 C.F.R. Part 200 applicable, with certain amendments, to HHS programs and supersede the Uniform Administrative Requirements for grants to states at 42 C.F.R. Part 92). The costs at issue here were incurred in 2010 before consolidation but the substantive provisions relevant here are unchanged. The prior versions of superseded circulars are available at https://www.whitehouse.gov/omb/circulars_index-slg/.

² In addition to the base payment, vendors would receive payments for foster care maintenance and residential treatment. The parties appear to agree that these payments are not at issue in the present disallowance. MO Br. at 3 n.2.

proposed to serve. MO Ex. 1, at AF11.³ The “firm, fixed price” must be stated for “each service,” meaning “base,” foster care maintenance, and residential treatment. *Id.* The bidder must also break down the total “base” price into case management services, treatment services, resource development, admin/overhead, crisis fund expenses, and special expenses, with the items composing each to be listed in the bid proposal. *Id.* at AF14. We discuss this breakdown in detail later in the decision.

The bidders were provided with rate ranges for different geographic areas broken down into case management, resource development, and treatment (including special expenses, room and board, and residential treatment), and administrative expenses (including those for room and board and residential treatment and all other administrative expenses) for different ranges of case numbers. MO Ex. 2, at AF23-36. The rate ranges were developed for Missouri by an actuary and included in each category a lower bound price PCPM, an upper bound PCPM, and a target rate PCPM. *Id.*; MO Br. at 4 (the actuarial consultant used “a cost survey and time study, state agency costs, and contractors’ financial reporting” to develop these ranges). For area 1, bidders were instructed that their price proposals should not “exceed the upper bound PCPM overall monthly case rate identified in” the actuary ranges for that region. MO Ex. 1, at AF13. Missouri points out this requirement meant that the bidders were permitted to “submit bids that exceeded the upper bounds on individual rates, but not the upper bound for the overall monthly case rate.” MO Br. at 5.

This appeal involves a single FCCM contractor,⁴ Children’s Permanency Partnership, LLC (CPP), which bid a firm, fixed base price of \$814.83 PCPM for the base services in each range of cases in area 1 (which includes St. Louis) up to 525 cases. MO Ex. 3, at AF38, 41. The component rates offered by CPP consisted of case management (\$524.57 PCPM), **resource development (\$77.40 PCPM)**, crisis/treatment/special expenses

³ The ranges varied by area, but in area 1, for example, were 210-315 (a minimum for which every bidder must offer a price), 316 -420, 421-525, and 526-630 cases, with corresponding levels of supervision. MO Ex. 1, at 11. Specifically, each bidder could select a maximum from the ranges available (such as 421-525 cases) but must also quote prices for each of the lower ranges available (i.e., for that maximum in area 1, the bidder would also have to submit prices for the two lower ranges). *Id.*

⁴ At times in the disallowance and in its brief, ACF makes broader comments but the audit and the disallowance letter show that the amount at issue in the present appeal arises from claims relating to only one contractor in a single area only for its resource development activities and only in FY 2010. ACF Ex. 3, at 2-3; ACF Ex. 1, at 1-3, 5-6; *see also* ACF Br. at 4-5. We therefore highlight the relevant amounts.

(\$55.68 PCPM), and administration (\$157.18), which add up to the total rate of \$814.83 PCPM. MO Br. at 5, citing MO Ex. 3, at AF41-44. The disputed claims are for payments to CPP for resource development in 2010.⁵

The actuary's calculated rates for area 1 for 2010 for a caseload of 196 are in the record. MO Ex. 2, at AF36. The upper bounds for the component rates were case management (\$561.31 PCPM), **resource development (\$55.45 PCPM)**, crisis/treatment/special expenses (\$84.81 PCPM), and administration (\$176.14 PCPM). *Id.* These components sum to an upper bound base rate of \$877.71.

Missouri explains that CPP's bid was accepted even though the proposed resource development rate exceeded the upper bound calculated by the actuary, because "the overall monthly rate was below the overall monthly upper bound calculated" by the actuary. MO Br. at 5. Missouri further states that it paid CPP (and the other successful contractors) in 2010 "pursuant to the fixed PCPM rates established through the 2008 bidding process," and that out of "these four sets of rate payments made to CPP," two – the case management rate payments and resource development rate payments – were claimed in part as Title IV-E expenditures. *Id.* at 5-6. According to Missouri, the aggregate payments for case management and resource development were allocated to Title IV-E based on application of a penetration rate. *Id.* at 4.⁶

3. History and basis of disallowance

a. Audit findings

During the single state audit of Missouri's federally-funded programs undertaken in March 2011, the State auditors reviewed Missouri's "contracts with ten performance based case management contractors, each a consortium of multiple local agencies, to provide case management and room and board for children in state custody" which were

⁵ We note that the actuary did not, in fact, provide a separate total base rate PCPM, however. Instead, the actuary added these elements with the rates for room and board (upper bound \$346.03 PCPM) and residential treatment (738.73 PCPM) to report an overall monthly case rate upper bound of \$1,962.47 PCPM. MO Ex. 2, at AF36. (CPP's rate for the foster care maintenance (room and board) was \$382.50 PCPM and for residential treatment was \$759.15. MO Ex. 3, at AF41). Thus, CPP's overall monthly case rate was \$1,956.48. This is consistent with CPP's assertion in the narrative portion of its bid that its pricing was "\$5.99 below the maximum allowed" by the actuary's study. MO AF at 42.

⁶ A penetration rate generally involves a ratio of children served under title IV-E to the total number of foster care children. *See, e.g., Ohio*, DAB No. 2643, at 15; *Missouri*, DAB No. 1783, at 8, 25. ACF does not dispute that an appropriate penetration rate was applied. Missouri asserts that the payments for crisis/special expenses rate payments were claimed under the Social Security Block Grant program and that administrative costs were allocated across benefitting programs. These assertions are also undisputed.

awarded in 2008 and renewed into 2010.⁷ ACF Ex. 3, at 2 (ACF submitted as its exhibit only pages 74-76 of the audit report which contain the finding relevant to the current disallowance). The auditors found that the contractors were “paid a monthly fixed price for 1) case management/administration, 2) room and board, and 3) residential treatment for a pre-established caseload.” *Id.* (The “case management/administration” price appears to correspond to the “base” price as discussed above from the RFP.)

The auditors explained their understanding of how costs for the contracts were determined and allocated, as follows:

While contractor costs associated with room and board and residential treatment are allocated to applicable federal programs based on actual costs incurred by the contractors, the costs associated with case management/administration are allocated based on the original budgets submitted by the contractors in their 2008 requests for proposal. Each contractor budget separates case management/administration costs into six categories and the [state] allocates these costs to several federal programs. Case management services and resource development costs are allocated to the Foster Care administration and training programs, respectively.

Id. Based on this understanding, the auditors concluded that Missouri “has not established procedures to ensure all payments to performance based case management contractors are properly allocated to federal programs” and that “some contractor payments are allocated to federal programs based on unrealistic budgeted expenditure categories rather than actual expenditures.” *Id.*

The auditors further found that, even though Missouri received monthly reports of actual costs from the contractors, it “does not use this information to allocate case management/administration costs to the specific federal programs . . . [and] has not performed procedures to determine if budget-based allocations are representative of actual costs incurred.” *Id.* The auditors reported that they reviewed 2010 expenditure reports for three contractors and noted that “the budgeted cost allocations did not appear representative of actual costs.” *Id.* Specifically, as to one contractor, CPP, the auditor found that “\$333,904 was allocated to the Foster Care (training) program during state fiscal year 2010 for resource development costs, while the contractor reported actual

⁷ The record does not make clear whether CPP fits the auditors’ description of the FCCM contractors as consortia of local agencies. Neither party identified any relationship between CPP and any local agencies; and Missouri instead described its payments to CPP as made to a “private” FCCM contractor. MO Br. at 1. ACF did not dispute the description.

expenditures for that activity totaling only \$165,336,” meaning that “\$168,568 (\$76,702 federal share) more was allocated to the Foster Care program than actually spent by this contractor for that category.” *Id.* at 2-3. (We note that the example given by the auditors corresponds to the costs at issue in the present disallowance.) The auditors found that Missouri failed to “review or adjust the allocations for this contractor to ensure future allocations” would be “more representative of actual costs.” *Id.* at 3. Finally, the auditors advised that, “[w]ithout periodically analyzing actual cost data and allocating costs based on such data, [Missouri] cannot ensure the costs are allowable and allocable to the various federal programs.” *Id.*

The auditors thus treated the room and board and residential treatment payments under the contract as fixed rate payments but treated the case management and administration payments as cost-based payments. We note that the auditors did not question the allowability of any of the actual costs incurred by CPP. Instead, the auditors opined that the cost-based payments to CPP required reconciliation to actual cost experience before they could be properly allocated to title IV-E.

b. Missouri’s response and corrective action plan

Missouri responded that it “partially agree[d]” with the finding and that it was submitting a corrective action plan to include “an explanation and specific reasons for our disagreement and any planned actions to address the finding.” ACF Ex. 3, at AF3. That plan explained that Missouri “contracted with an actuary to establish a rate range to help guide” its evaluation of bids by prospective contractors of “a rate to provide foster care case management services for the duration of the contract.” ACF Ex. 6. Missouri further asserted that “[t]he purposes of requesting the costs reports for the case management and administration components of the contract” were to review compliance with State law “requiring payments to foster care case management contractors to cover reasonable costs – and to help validate future rates.” *Id.* While stating that it did not “entirely agree with the finding,” Missouri stated that it would rebid the contracts competitively in 2011, would have a third party evaluate reports and suggest process improvements, and would require contractors “to certify that the rate bid will cover their actual costs.” *Id.*

c. Disallowance

ACF stated in its disallowance letter that it concurred with the audit findings and recommendations and found the proposed corrective actions inadequate. ACF Ex. 1, at 4.

ACF cited to the instructions for reporting quarterly expenditures under Title IV-E as follows:

Expenditures are actual payments made to vendors, service providers and contractors or actual payments for administrative, personnel, or other cost items. Include also indirect costs allocable to the quarter being reported in accordance with an approved or pending cost allocation plan or negotiated indirect cost rate.

To be allowable, all amounts reported must be expenditures made under the . . . approved title IV-E plan for administration, training and systems costs or for payments made on behalf of children determined eligible for title IV-E. Amounts reported must be in accordance with all applicable statutes, regulations or policies, and, where necessary, using the methodologies in an approved or pending public assistance cost allocation plan (States)

* * *

Expenditure estimates are not acceptable in these [expenditure] columns. "Advances" of funds to another State or Tribal agency, a local agency or a private entity are not considered expenditures for these purposes. The amounts reported in these columns must be actual, verifiable transactions supported by readily available accounting records and source documentation or an approved cost allocation plan or an indirect rate agreement, as applicable.

Id. (quoting Program Instruction ACYF-CB-PI-13-06; added emphasis in letter omitted).

ACF noted Missouri's contention that, "since they treat their FCCM contractors as vendors, their contracted vendor's costs are not subject to federal requirements." *Id.* at 5. ACF quoted Missouri's explanation that the contractors were obtained through a competitive bidding process to provide specific services to the Missouri state agency and were not subgrantees. *Id.* Hence, in Missouri's view, the agency's payments to the vendors/contractors constituted the expenditures subject to all federal requirements, whereas the contractors' own actual costs were not expenditures subject to federal guidelines. *Id.*

ACF disagreed with this position for the following reasons:

Regardless of whether a vendor or sub-contractor, only actual costs for allowable program activities may be claimed to title IV-E. Using a competitive bidding process alone does not meet the requirements of title IV-E claiming. Missouri's contracted case rate payments constitute unallowable "advances" of funds since they are not supported by readily available accounting records and source documentation or an approved cost

allocation plan or an indirect rate agreement. Furthermore, in accordance with applicable federal regulations at 45 CFR Part 75.405, costs must be allocated to a federal program based on relative benefits received. The use of budget estimates that are then not adjusted to reflect significant differences with actual expenditures does not meet this requirement.

Id. ACF thus found Missouri's corrective action plan inadequate because Missouri planned to continue claiming based entirely on the rates resulting from competitive bidding and using information collected about vendors' actual costs only for purposes of evaluating budget categories for future contract award bidding rather than to adjust the payments made under the existing contracts. *Id.* at 4-5.

ACF went on to disallow the \$76,702 (federal share) amount cited by the auditors as exceeding actual costs for one contractor.⁸ *Id.* at 5.

Analysis

1. Scope of the current dispute and arguments of the parties

The dispute before us addresses only the disallowance of \$76,702 in FFP for the resource development charges by CCP which Missouri originally claimed as training costs of its Title IV-E program. As we discuss later, other audit findings or observations, and certainly issues relating to future reviews of the Missouri foster care system, are not ripe for our review.

Missouri's position is essentially that ACF has failed to understand the distinction between purchasing services from a vendor and claiming costs for services performed by the state agency or its sub-grantees. MO Br. at 1, 8-10. Missouri contends that its expenditures are its payment of the fixed rates in the contract for the number of children assigned. Missouri views the "budget categories" in the RFP and the contract bid as requests for and offers of rates for each of the categories under which the state plans to provide services. According to Missouri, none of the rates are billed based on estimated or budgeted amounts and the payments are not advanced to the vendor/contractors for later reconciliation to actual costs but rather constitute final payments for services received.

⁸ ACF also announced further actions it planned to take to review Missouri's title IV-E program claims and requested documentation from Missouri for that review. *Id.* at 5. We discuss those documentation requests later in this decision because ACF also asked us to order the production.

ACF reiterates that Missouri “has received reimbursement for costs based on budgeted amounts paid to contractors.” ACF Br. at 7. Since the auditors found that the actual costs submitted by one contractor were “significantly less than the budgeted and paid amounts claimed by Missouri,” the difference may be either unallowable profit to the contractor or represent services delivered in other categories but not allocable to title IV-E. *Id.*

2. Agency document request

As noted earlier, the disallowance letter indicated that ACF was pursuing a larger review of Missouri’s foster care claiming practices since FY 2010 and stated that more information was needed to fully resolve audit findings. ACF Ex. 1, at 5-6. In addition to repaying the disallowed amount, Missouri was asked to provide within 30 days the following:

1. Administrative claims documentation: Please provide:
 - All monthly actual cost reports from each contractor for FFY2010;
 - A readily reviewable summary comparison of the FFY2010 actual costs incurred for each cost category by contractor versus the amounts allocated and claimed to IV-E foster care case management, IV-E foster care training (both 50% and 75% FFP rates), and general administration costs (which are then charged to several federal programs including foster care).
2. Maintenance claims documentation: Please provide readily reviewable source documentation, such as cancelled checks and/or direct deposit statements, for a soon-to-be-provided ACF selected sample of maintenance claims. Please note that our selection of this sample has been substantially delayed due to various significant unallowable claiming issues found early in our review efforts when we tried to identify the universe from which to select our sample. We anticipate being able to select a sample of claims in the next month or so. Once we provide the sample, we will then request readily reviewable supporting source documentation to be provided within 30 days for the sampled claims.

ACF now asks us to order production of all of these documents requested in the disallowance letter without delay, “[r]egardless of how the Board rules on the underlying disallowance.” ACF Br. at 12-13.

The Board permits limited discovery and otherwise develops the record as necessary and appropriate to ensure a prompt, sound decision in the case before it. 45 C.F.R. § 16.9. ACF does not explain why the cost information concerning contractors for which no disallowance decision has yet been made would be relevant to resolving the disallowance

currently before the Board. Indeed, on the face of the disallowance letter, it is clear that the document requests relate to potential future actions that may be taken based on an ongoing review and sampling process not yet even underway. Board proceedings are intended to be adjudicatory in function, resolving disputes which are ripe for adjudication and employing discovery only as necessary to complete a record for a sound decision on the case before it. ACF has not shown that the information sought is necessary or even relevant to the Board's decision in the case before it. To the extent ACF seeks information on issues that may influence potential future actions arising from the same audit, ordering production of such information is not an appropriate Board function. ACF has ample authority to pursue oversight of title IV-E claims submitted by Missouri and issue any further disallowances which it deems appropriate in the future without requiring Board intervention in advance. We therefore decline to order the requested document production as part of this proceeding.

3. Missouri has conceded that the resource development rates included costs not eligible for the enhanced FFP for training.

As mentioned earlier, Missouri charged the resource development payments to the contractor at issue here to title IV-E as training costs which are reimbursed at an enhanced rate of FFP of 75 percent. During the course of this proceeding, Missouri described the resource development rate in its brief as covering both recruitment and training of foster families. MO Br. at 1. This description is consistent with the delineation of the services its actuary used to calculate the range of rates for different geographical areas for resource development services as "recruitment and training of foster homes." MO Ex. 2, at AF17, 19.

The enhanced rate for training under title IV-E is available for short-term training for foster parents who are or will be caring for children under the program. 42 C.F.R. § 1356.60(b)(1)(ii). Recruitment of foster homes is also an allowable title IV-E activity but is reimbursable only at the normal administrative FFP rate of 50 per cent. 42 C.F.R. § 1356.60(c)(2)(vii). ACF points out in its brief that recruitment is not a training program and is not eligible for the enhanced funding provided for specified training activities. ACF Br. at 13.

In its reply, Missouri conceded that not all of the activities which were included in its resource development payments qualified as training eligible for the enhanced rate. MO Reply Br. at 1-2. Because it paid the contractor for those services by a flat fixed rate payment per child per month, Missouri states that it has no way to determine what part of its payments to the contractor for resource development were for training activities eligible for enhanced funding. *Id.* Therefore, Missouri agrees to refund \$25,568 of the disallowed amount which Missouri asserts is the difference between 50% and 75% FFP. *Id.* at 2. ACF has not indicated any disagreement with this calculation.

We therefore uphold \$25,568 of the disallowance without further discussion. The remainder of this decision addresses the \$51,134 which remains in dispute.

4. The resource development payment to CPP was based on a fixed rate not a prospective budget estimate.

ACF states that the current disallowance centers on the difference in claiming “budgeted estimations of costs and actual costs.” ACF Br. at 7. Missouri acknowledges that the program instructions require “actual, verifiable transactions” rather than advances or estimates as the basis for claims for reimbursement of expenditures. MO Br. at 10, quoting MO Ex. 6, at AF102 (ACF disallowance letter which in turn quoted from PI ACYF-CB-PI-13-06). Missouri argues, however, that its payments to the contractor for set amounts based on a contractual agreement for a set price per child per month for particular services constituted the “actual, verifiable transactions.” MO Br. at 11. These payments, according to Missouri, are consistent with the program instructions defining expenditures to include “actual payments made *to* vendors, service providers and contractors or actual payments for administrative, personnel, or other cost items.” *Id.* (internal quote from same program instruction, emphasis in Missouri brief).

This core issue of whether the claims here were budgeted estimations, as ACF contends, revolves around whether the payments Missouri made to CPP were final payments to a vendor for services purchased or whether instead those payments were preliminary or interim payments that should have been reconciled to CPP’s own actual, verifiable costs before claiming federal reimbursement. It is undisputed that payments to fixed-price contractors may constitute actual, verifiable transactions, as indeed the regulations in effect at the time specifically provide. 45 C.F.R. § 92.22(a)(1)(2014). The auditors, and ACF in its disallowance letter, describe the payments here, however, as being made not as fixed price rates but rather made based on “unrealistic budgeted expenditure categories” (ACF Ex. 1, at AF2, disallowance letter quoting audit) and as “budget estimates” (*Id.* at AF5, disallowance letter). ACF’s interpretation appears to arise mostly from a chart in the RFP calling for pricing under “budget categories,” rather than as, for example, “rate components.” MO Ex. 1, at AF14. Missouri argues that ACF, as well as the auditors, misunderstood the contractual arrangements which were not based on estimated budgets or cost reimbursement but solely on fixed rates for performance. MO Br. at 8-10.

To understand the nature of the payments arising from this contract, we must look first at the language of the RFP and contract as a whole, as well as the aforementioned chart.⁹ Because the language is not without ambiguity, we interpret it in the context of the title IV-E program and in light of the course of dealing between the parties to the contract.

What is undisputed is that the RFP sought sealed competitive bidding for FCCM services to be purchased by the state agency. MO Ex. 1, at AF2, 9. The RFP overall is expressly characterized as requiring bidders to bid “a firm, fixed price for each service within the range of cases (Base Price, Foster Care Maintenance, and Residential Treatment) for the entire three years of the contract.” *Id.* at AF11. Bidders in different geographic ranges must bid on the mandatory number of cases and may bid on other case ranges. *See, e.g., id.* at AF11-13.

The bidders were provided with the actuary’s calculated rate ranges for “informational purposes,” but were warned that Missouri did not “warrant” or “imply” that these ranges “in any way reflect the actual costs that will apply to the services required in this RFP.” MO Ex. 1, at AF10. Bidders were also advised the “proposed price shall apply to all three years of the contract,” including the two renewal years, unless the state raised foster case maintenance and residential treatment funding beyond increases already allowed for in the calculation of the actuarial rate ranges. *Id.* at AF11. In the latter case, bidders might be allowed to “request an amount” up to a maximum to be set by the state agency but only as to “the firm, fixed price for the specific service within the range of cases which received additional appropriations.” *Id.* The RFP thus offered no assurance that the rates would ensure that all costs were covered (beyond the information that the actuary provided about predicted ranges) nor a provision for cost-based pricing.

Missouri further argues that neither the RFP nor the CPP contract provides any mechanism for retrospective adjustments of either total price or of “the different rates that comprise it” based on reported costs during the performance period. MO Br. at 10. Our review confirms this, and ACF has not argued that other unsubmitted parts of the RFP or the CPP contract provide Missouri any authority to revisit the rates during the term of the contract based on CPP’s actual cost experience or to alter payments to reconcile prospective rates to later actual cost data from CPP. MO Exs. 1 and 3 *passim*.

We thus observe that the overall structure of the RFP appears consistent with Missouri’s description of a contractual relationship based on firm fixed rates for services delivered. The ambiguity underlying this dispute arises largely from a single page provided from the

⁹ Our review is necessarily based on the excerpts of the documents submitted by the parties. ACF has not argued that, either during the audit or during this proceeding, it lacked access to the complete RFP and CPP contract, and it did not supplement the record with any parts of those documents inconsistent with our analysis here.

RFP entitled “Exhibit H Price Analysis” which bidders were to complete as part of their proposals. MO Ex. 1, at AF14. Neither party has provided surrounding pages to this RFP Exhibit, so any instructions that may have been provided to bidders for its completion are unavailable.

Missouri points out, accurately, that the RFP and contract contain no references to “budget estimates,” on the Exhibit H pages or elsewhere. MO Br. at 10, citing MO Exs. 1, at AF14, and 3, at AF42-44. The Exhibit H Price Analysis page does, however, contain a chart with two columns labelled at top “Budget Categories” and “Total.” The chart is divided into six pre-labeled sections identified as follows: Case Management Services (list); Treatment Services (list); Resource Development (list); Admin/Overhead (list); Crisis Fund Expenses (list); and Special Expenses (list). Each section has four lines which bidders may fill in and for which total amounts may be filled in the totals column and then a pre-labeled line for the total services for that section and a space in the totals column for the cumulative total for that section. The CPP contract’s completed price analyses pages (for different options as to the number of children served) each break down the same per-child per-month resource development price (totaling \$77.40) into two listed items resource development staff (\$72.60) and resource development non-compensation costs (\$4.80). MO Ex. 3, at AF42-44. Missouri’s position is, in effect, that the bidders were required by Exhibit H to propose prices broken down into rates for each of the sections set out in the chart (for each of which they might further identify the included components on the lines provided) rather than being asked to estimate their own anticipated future costs in each category. While the use of the term “budget categories” was less than clear, in the context of the price analysis chart, Missouri’s position is plausible.

We conclude that, overall, the review of the contractual excerpts thus supports the characterization of the resource development payments to CPP as performance-based fixed rates rather than interim or estimated payments requiring later reconciliation. Given the potential ambiguity created by the use of the term “budget” in Exhibit H, we also looked to the course of dealing to determine if the conduct of the parties was consistent with this interpretation of the contract. Missouri argues that its longstanding practice under the FCCM was to make payments based on the fixed fee rates for the components (as well as the aggregate base price rate) and that its payments did not fluctuate based on contractors’ costs. MO Reply Br. at 6. Missouri argues that this history supports its interpretation of the contract, to which we should defer. *Id.*

Two elements about the course of dealing between Missouri and its FCCM contractors identified by the auditors, however, raised questions about whether the categories were indeed intended to simply break down the pricing into categories for which Missouri

wanted rates for its own budgeting or planning purposes or instead did represent proposed budget estimates of the contractors' costs. We next consider whether the record on these two elements undermines the conclusion that the payments are based on fixed rates for resource development services.

First, as noted earlier, the auditors asserted that two components of the fixed price contract (foster care maintenance and treatment) were ultimately reconciled to actual costs. ACF Ex. 3, at 2. If this were so, it would undermine the claim that Missouri never intended payments for resource development under the CPP contract rates to later be reconciled to contractors' actual costs. ACF, however, disowned the auditors' finding in its disallowance. ACF Ex. 1, at 6.¹⁰ Therefore, no evidence appears in the record that any components of the contract were retrospectively reconciled based on contractor actual costs.

Second, ACF points out that Missouri collects information about the actual costs incurred by FCCM contractors during the period of the contracts. ACF Br. at 4.¹¹ This fact might suggest that Missouri indeed expected a cost-based reconciliation process to take place after the contract was in effect. It is undisputed that no such reconciliation process occurred with the CPP resource development payments, and likely not with any of the payments made based on rates in the FCCM contracts. Missouri offers an explanation of why it collected the cost data despite not intending to use that information in retrospectively changing its payments to the contractors. According to Missouri, the data were to be used for the evaluation of "the reasonableness of the future fixed price contracts," in other words to replace the role of the actuary's price ranges (*see* MO Br. at 9), and also in order "to analyze any potential claims that a particularly high cost child was not financially feasible" for a particular FCCM contractor.¹² *Id.* at 6. In its

¹⁰ The disallowance asserts that although "the auditor states that the maintenance portion of costs were *'based on actual costs incurred by the contractors,'* ACF since "determined that the auditors did not review copies of checks or direct deposits made by the contractor to the foster family homes or group homes but instead only reviewed the Missouri . . . reports of maintenance payments made to the contractors." ACF Ex. 1, at 6 (italics in original).

¹¹ ACF actually quotes the auditors as finding that, even though contractors "submit monthly reports of actual costs," Missouri "does not use this information to allocate case management/administrative costs to the specific federal programs," as it "did with room and board and residential treatment costs, and other categories of costs such crisis fund expenses and special expenses." ACF Br. at 4, quoting ACF Ex. 3, at 2. This quotation compounds the confusion, however, since crisis fund expenses and special expenses are element of the base rate price which ACF has never suggested were being reconciled to actual costs. Nothing in the record at this point supports any conclusion that any retrospective actual costs review was used for any elements of the base rate.

¹² The latter use of the data is consistent with the following statement in CPP's contract bid: "In the event a catastrophic or extraordinary level of care is needed for a child where CPP has already paid \$80,000 and it is expected the costs will exceed \$200,000 in the contract year, CPP will provide in person to the state agency all information required . . . for consideration by the state for additional funding assistance." MO Ex. 3, at AF40.

corrective action plan, Missouri provided an additional purpose for the data collection – reviewing the state’s compliance with a state law requirement that payments to FCCM contractors cover reasonable costs. ACF Ex. 1, at 3, quoting Missouri’s corrective action plan which cited R.S. Mo. 210.112.4(6). Missouri categorically denies that any of the collected data affected payments made to any contractor during the term of the contract, which payments were, as stated, “governed by the fixed rates established through the competitive bidding process.” MO Br. at 6.

We conclude, based on the record before us, that Missouri’s payments to CPP for resource development were made based on prospective fixed fee rates for services provided and were not based on budget estimates. The CPP contract anticipated fixed pricing throughout the term and did not provide for retroactive reconciliation to actual costs of the contractor during performance.

5. None of ACF’s legal arguments persuade us that payments made under fixed fee contracts must be reconciled to the contractor’s actual cost experience under the contract.

ACF focused its arguments in the disallowance and in the proceedings on appeal on the assumption, which we have found to be mistaken, that the CPP contract provided for cost-based reconciliation of case management/administrative services payments. At times, however, ACF appeared to suggest that, even if a contract called for fixed fee payments for all services, Missouri might still be required to demonstrate that the payments correlated to the contractor’s cost experience. It was difficult, at times, to disentangle ACF’s legal and policy arguments from its mistaken factual premise.

ACF does not dispute that fixed price contracts are expressly permitted by regulation. ACF Br. at 8, citing 45 C.F.R. § 92.22(a)(1). Nevertheless, ACF argues that Missouri did not properly apply or implement its use of such contracts here. Missouri cites the same provision in support of the CPP contract. MO Br. at 11. Section 92.22(a)(1) provided as follows:

- (a) Limitation on use of funds. Grant funds may be used only for:
 - (1) The allowable costs of the grantees, subgrantees and cost-type contractors, **including allowable costs in the form of payments to fixed-price contractors; . . .**

(Emphasis added.) ACF appears to suggest that the use of the phrase “allowable costs” in the regulation necessarily means that only actual costs of a contractor may be reimbursed even under fixed-price contracts. ACF Br. at 11. ACF, however, does not clearly explain either its reading of the regulation or why we should defer to that reading as reasonable. An alternative reading is that the use of grant funds is limited to “allowable costs” when those costs are incurred by grantees or their cost-type contractors (i.e., when the grantees

use cost-based contracts making the grantees liable for the costs incurred by contractors), **and** that those allowable costs of grantees include their payments to fixed-price contractors (i.e, when the grantees do not agree to cover a contractor’s costs but rather agree in advance to a fixed price or rate).

We are particularly concerned that ACF has not explained how its suggested reading intersects with recognized distinctions between cost reimbursement and fixed price contracting, distinctions discussed in Board decisions in the context of federal procurement rules for direct federal awards. *See, e.g., Miss. Dept. of Public Welfare, DAB No. 700 (1985)*. To put it in broad terms, the core characteristic of a fixed price or fee contract is usually that the party awarding the contract is in essence buying a product or service from a vendor, and the contractor bears the risk that its costs may be greater than anticipated but the price for its services is already set.¹³ By contrast, in a cost reimbursement arrangement, a grantee generally agrees to cover the costs of a contractor providing a deliverable and thus the costs of the contractor are effectively expenditures of the grantee and therefore themselves subject to cost principles governing grantee expenditures.¹⁴ If this distinction is applied to fixed price contracts awarded by grantees, and ACF has not argued that it may not be applied in this context, it seems the allowability and reasonableness of the transaction would largely depend on whether the purchase is appropriate under the particular grant, not on what the contractor spent to produce the product or service. In short, ACF’s assertion that the grantee’s payments to the contractor under the fixed-rate contract in this case must reflect the contractor’s actual costs seems to ignore the fundamental distinction between fixed-rate and cost reimbursement contracts. In addition, ACF identified no prior situation in which a federal grantor under this regulation required that a state grantee demonstrate that its fixed price payment to a contractor was limited to the contractor’s own actual costs and that those contractor costs themselves complied with cost principles for state grantees. Absent such identification, this appears to be a novel requirement which we would expect to have been explained more clearly. In short, ACF has not persuaded us that the position it appears to take here is a basis for upholding the disallowance.

We also note that, while grantee procurement regulations provide that “[c]osts or prices **based on estimated costs** for contracts under grants will be allowable only to the extent that costs incurred or costs estimates included in negotiated prices are consistent with Federal cost principles (see [section] 92.22)” (45 C.F.R. § 92.36(f)(3) (emphasis

¹³ As mentioned earlier, the CPP contract contained language consistent with this understanding, as well as allowing for seeking some relief in the case of a child requiring extraordinarily costly care.

¹⁴ Obviously, a wide range of different contract vehicles with differing and overlapping characteristics exist in both government procurement and commercial contexts, so this simple framework is not intended to exhaust the possibilities that may be presented by a particular arrangement. Therefore, the Board reserves the possibility that a particular vehicle in circumstances different than those presented here may call for a different analysis.

added)), they contain no similar language regarding contracts made by grantees that are **not** based on estimated costs. 45 C.F.R. § 92.36. As explained above, we have concluded the contracts here were not based on estimated costs. Thus, the statement in the grantee procurement regulations applying cost principles to costs for contracts **based on estimated costs** (together with the cross-reference to the language in section 92.22), along with the absence of any corresponding language or cross-reference in regard to contracts **not** based on estimated costs (such as fixed fee contracts) further support a conclusion that allowable payments under fixed price contracts are distinguished from those under cost-based or estimate-based contracts. ACF has not persuaded us that, given the recognized distinctions between fixed-price and cost reimbursement contracting, a grantee is required to reconcile payments under a fixed-price contract to the contractor's actual costs.

Furthermore, ACF's assertion (responding to Missouri's statement that nothing in the grantee procurement rules requires payment based on actual costs) that "[p]rofit (to a grantee or a contractor) is not an allowable cost" under section 92.22, ACF Br. at 11, directly contradicts the plain language of section 92.22(a)(2). That section permits grant funds to be used in payments that include "profit to cost-type contractors but not any fee or profit (or other increment above allowable costs) to the grantee." *See also* 45 C.F.R. § 92.36(f)(2). ACF also cites generally the Office of Management and Budget (OMB) Circular A-87 for the same proposition, but its provisions prohibited profit by grantees or subgrantees without speaking to whether a contractor may realize an increment above cost in a fixed fee or price contract.

We emphasize that, in discussing the differing nature of contractual vehicles and by declining to uphold the disallowance here because ACF did not address how those differences might affect that disallowance, we are not holding that grantee payments under fixed price contracts are immune from review for whether they themselves meet the requirements of allowability or that reviewers (including the Board) cannot look behind questionable contracts, such as for impropriety in the contracting process. *See* DAB No. 700, at 28 (fixed-price contracts awarded by state using largely federal funds not immune from review just because they were fixed-rate; contracts "would merit scrutiny in any event . . . since the award was intertwined with an 'influence peddling' and bribery scheme"). We discuss these points further in the next section of this decision. The narrow issue here is whether, in the context of fixed-price contracts, a grantee is subject to a disallowance if its payments of contracted rates to the contractors do not appear to be representative of the contractor's actual costs. We also note that the grantee procurement regulations provide many requirements that **are** enforceable on grantees using fixed-price contracting, such as making analyses of the most economical procurement approach, using only responsible contractors, documenting the basis for a

contract price (including independent estimates of cost/price prior to bidding) and using appropriate bidding or proposal procedures. 42 C.F.R. § 92.36. (Here, ACF has not identified any allegedly improper procurement practices or any improper or unallowable costs incurred by CPP under the contracts.).

ACF also asserts that the payments to CPP do not constitute “proper expenditures” because Missouri did not “include its FCCM contracting practices” in any state plan or cost allocation plan. ACF Br. at 12. Missouri provided its title IV-E state plan which Missouri contended consisted of a federal preprint, listing federal requirements, “with a column for the State to fill in the state regulatory, statutory, and policy references” showing compliance, and with no “section regarding payment methodologies for private contractors conducting administrative activities.” MO Reply Br. at 8, citing MO Ex. 8. Missouri further denies that the contracting mechanism needed to be discussed in its cost allocation plan. *Id.* at 5. Without further elucidation from ACF about specific requirements for the state plan or cost allocation plan that required more information about these contracts, we are not able to make any finding that the state payments to CPP for resource development services under the contract were somehow not proper expenditures.

ACF cites as well general instructions in its manual that all claims must be for actual expenditures for title IV-E supported by accounting records and source documentation. ACF Br. at 12. It appears that ACF is arguing that CPP’s costs as contractor were not adequately documented, rather than that Missouri’s payments to CPP under the contract were not accounted for. This argument no longer appears relevant in light of our discussion above regarding the differences between fixed-price and cost reimbursement contracts and ACF’s failure to discuss how the actual costs of the contractors (as opposed to the state grantee) are relevant in light of those differences. Missouri states in its reply brief, and ACF did not seek to deny, that it provided to the state auditor and offered to ACF the underlying documentation for its payments to CPP, such as state accounting records and contractor invoices. MO Reply Br. at 3.

We conclude that ACF has not established in this case that the rules it cites restrict the use of fixed fee contracts by states to purchase services from contractors or constrain those contracts to cover only the actual post-performance costs incurred by the contractors. We note that we need not address what action a grantee or a federal funding agency may take if a contractor is found to have charged improper items to a contract, since the issue before us is not whether CPP’s costs were proper or even allowable, but whether Missouri was required to limit its payments under the fixed-price contract only to the amount of actual costs CPP incurred in fulfilling the contract.

In short, we find no basis to uphold the remaining disallowance based on ACF’s argument that Missouri failed to ensure that its payments under the CPP contract reflected only actual allowable costs incurred by the contractor. However, as we address

next, we cannot determine on this record whether Missouri's own payments to the CPP were allowable, i.e. reasonable and necessary in kind and amount for carrying out purposes of the grant.

6. *The final allowability of the payments made under the CPP contract cannot be fully determined based on the present record.*

Nothing we have said above should be read as implying that use of a fixed fee vehicle, while permissible, insulates the state from the requirements that costs incurred in administering the title IV-E program must be reasonable and necessary or that the items and services purchased through the contract must be shown to have been received or performed as paid for. Even though ACF has not persuaded us here that the reasonableness of individual contractor expenditures is relevant in the fixed fee or price contract context, the Board has made clear that "necessity and reasonableness of the payments claimed for FFP and the quality and amount of the services rendered" are not "beyond the scope of the Board's review" of payments made under fixed price contracts. DAB No. 700, at 26.¹⁵ That is to say, the payments made **by the grantee** in purchasing the contractual services must be for a purpose needed under the program involved, must be in an amount (i.e., at a price or rate) that is reasonable to incur for that purpose, and must correspond to the receipt by the grantee of performance of services appropriate to the amount paid for them. The granting agency, and the Board, have ample authority to review a grantee's payments to a fixed-price contractors regardless of how the grantee's payments relate to the costs incurred by the contractor in delivering the purchased services.

ACF argues, correctly, that the Board has previously found unallowable contractual arrangements that are not reasonable and necessary for the proper administration of a federal grant program, a requirement derived from OMB Circular A-87, Attachment A, ¶C.1.a. ACF Br. at 8, *citing Nebr. Health & Human Svcs.*, DAB No. 1660 (1998). In Nebraska, the state had hired a professional services contractor based on a contingency fee arrangement to maximize the state's revenue from federal grants. DAB No. 1660, at 2-3. The Board found that this use of a contingency fee contract made it impossible for the state to have performed an appropriate cost or price analysis in advance of making the procurement. *Id.* at 7. Furthermore, the contingency arrangement in that case detached the price from any relationship to the contractor's efforts or activities. Thus the Board explained:

¹⁵ Furthermore, where the awarding of the contracts involved suspicious conditions (allegedly involving bribes and noncompetitive awards) and "large illegal expenditures" were found to have been made relating to those contracts, the Board concluded that such misconduct remained subject to oversight by the federal agency "in order to properly administer the grant program whose funds are involved." DAB No. 700, at 29. At this point, however, ACF has made no similar allegations relating to the CPP contract specifically or the competitive bidding process for the FCCM contracts generally.

We conclude that the cost is not “reasonable” because the contingency fee arrangement fails to guarantee that the fee will bear an appropriate relationship to the amount of time and effort required to perform the professional service. In the context of the federal programs at issue, a consultant could expend a very small amount of time and effort and still obtain millions of dollars in fees under a contingency fee contract. Indeed, in the instant case, the total contract fee for less than a two-year period exceeded \$2.5 million, and the consultant was not required under the contract to provide any substantiation of the time or effort involved.

Id. at 6. Although ACF quotes some of this language, it does not explain how the reasoning applies to the present case involving a fixed fee based on a per child per month calculation. ACF also does not explain why the use of the actuarial ranges was not an appropriate pre-procurement cost or price analysis (as contended in Missouri’s reply brief at 7) or why the competitive bidding process did not represent a reasonable procurement mechanism under the circumstances here.¹⁶ ACF merely concludes that there is a “dearth of documentation supporting the reasonableness of the amounts paid to the contractor” here and repeats its request for broad document production. ACF Br. at 9.

We have already explained why a broad discovery process exploring Missouri’s FCCM contracting system is not an appropriate use of this proceeding. In the present proceeding the only issue developed before us relates to one component (the resource development rate payment) in one year of one fixed fee contract. We recognize that the rate for that component exceeded the upper bound calculated by the actuary in advance of the procurement (\$77.40 v. \$55.45 per child). The RFP, as we have noted, permitted individual rates components to exceed the upper bounds so long as the total pricing did not, which CPP’s did not. The state’s decision to accept this contract may or may not have been reasonable in light of the fact that higher costs in different categories had differing impacts on programs with state versus federal funding. We also recognize the conclusion of the auditors that the payment made to CPP for its resource development activities in 2010 exceeded its actual costs by the amount at issue. We cannot determine from this isolated fact whether the overall contract was reasonable in amount.

Our conclusions about the allowability of the payments made to CCP are, as we have pointed out, based on only the record here. ACF has repeatedly indicated that it believes that additional investigation and documentation review is called for to develop a further understanding of Missouri’s relations with its FCCM contractors, the reasonableness of

¹⁶ As both parties recognize, states were required by the regulations then in effect, 45 C.F.R. § 92.36, to comply with applicable procurement provisions.

the payments made, and other issues arising from the audit. We do not here prejudge the outcome of any future disallowances or other actions which may result from such further reviews, as it would be premature to attempt to resolve issues which have not been fully and appropriately developed.

Conclusion

For reasons explained above, we uphold \$25,568 and reverse \$51,134 of the disallowance at issue.

/s/
Sheila Ann Hegy

/s/
Constance B. Tobias

/s/
Leslie A. Sussan
Presiding Board Member