DEPARTMENTAL GRANT APPEALS BOARD

Department of Health, Education, and Welfare

SUBJECT: Michigan Department of Social Services
Docket Nos. 78-70-MI-CS, 79-159-MI-CS
Decision No. 76

DATE: JAN. 31, 1980

DECISION

These are appeals that are being considered jointly because they emanate from the same HEW agency and involve the same issue - whether the State may receive Federal financial participation (FFP) at the rate of 75% of the full value of non-expendable personal property which is purchased as part of an indirect cost pool and allocated in part to the Office of Child Support Enforcement (OCSE) or whether the value of the property must first be capitalized and depreciated. Although the dollar amounts involved are small, the issue is a substantial one.

Procedural Background

By letters dated June 22, 1978, (78-70-MI-CS) and June 28, 1979 (79-159-MI-CS), the Regional Representative, OCSE, notified the Michigan Department of Social Services (DSS) of disallowances of $820 (78-70-MI-CS) and $1,255.42 (79-159-MI-CS) for the cost of equipment and furnishings in excess of $300 per unit purchased under Title IV-D of the Social Security Act for the quarters ended March 31, 1977 (78-70-MI-CS) and December 31, 1978 (79-159-MI-CS). The DSS filed applications for review on July 20, 1978 (78-70-MI-CS) and July 26, 1979 (79-159-MI-CS). Since there had not been requests for reconsideration before March 6, 1978, the disallowances having been made after that date, the appeals proceeded under 45 CFR Part 16 (1978).

An Order to Show Cause was issued on August 20, 1979 in 78-70-MI-CS, and it and the responses were incorporated into both files, without objections from the parties.

Relevant Statutory and Regulatory Provisions

Title IV-D of the Social Security Act (Section 451 *et seq.*), effective August 1, 1975, established the program for enforcing the support obligations owed by absent parents to their children. Section 455(a)(1) states:

> From the sums appropriated therefor, the Secretary shall pay to each State for each quarter... an amount (1) equal to 75 percent of total amounts expended by such State during such quarter for the operation of the plan approved under section 454.

The implementing regulations for the Office of Child Support Enforcement can be found at 45 CFR 301 et seq. (October 1, 1976). Section 304.24 addresses the treatment of non-expendable personal property. 45 CFR 304.24(a)(1) states that items of non-expendable personal property costing less than $5000 per unit may be subject to FFP of 75% at the option of the IV-D agency in the State. This is subject to an exception in Section 304.24(a)(3) which concerns the treatment of property acquired by organizational elements treated as indirect cost centers or pools in a departmental indirect cost rate or in a department-wide cost allocation plan. In these situations, non-expendable personal property costing over $300 must first be capitalized and depreciated. The grantee receives FFP at a rate equal to 75% of the depreciation expense.

45 CFR 74.132 defines non-expendable personal property as:

> "tangible personal property having a useful life of more than one year and an acquisition cost of $300 or more per unit..."

45 CFR 304.10 states that 45 CFR Part 74, except for Subparts G (Matching and Cost Sharing) and I (Financial Reporting), is applicable to all OCSE grants.

Issues Raised by the Parties

The State asserts (Application for Review, p. 2) that 45 CFR 304.24(a)(3) contradicts Section 455 of the Social Security Act and is therefore invalid. It points to the wording of the statute which states that the Secretary shall pay 75% of the "total amounts expended," while the regulations require capitalization and depreciation of non-expendable personal property bought to operate the program.

Section 455(a) of the Social Security Act provides that a state will be reimbursed for a percentage of the total amounts expended during a quarter for the operation of the state plan. If a state buys a piece of equipment with a useful life of 10 years and uses it for 10 years, nine years of the cost was not expended in Year 1 for the operation of the state plan in that year, but only one year of the cost, so only 1/10 of the cost of the item would appear to be a cost for the first year's program. The expenditure incurred during a quarter for the operation of the plan would therefore appear to be not the whole initial cost but the depreciation expense.

Capitalization and depreciation of non-expendable personal property is in accord with normal accounting practices.

> By those accustomed to reading the language of accounting, a depreciation charge is understood as meaning the appropriate contribution for that year to the amount required to make

> good the cost of the plant which ultimately must be retired. (Justice Brandeis in his dissenting opinion in United Railways v. West, 280 U.S. 234, 268 (1930), disagreeing with the Court on a basic question of utility law but for a reason not relevant to this discussion)

Justice Clark, in the opinion of the Court in Massey Motors v. United States, 364 U.S. 92, 104 (1964) states:

> It is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes.

In an "Issue Paper" submitted along with its application for review, the State argues that it is in effect financing the federal share of the asset costs pending the write-off of costs by depreciation. Its argument is accompanied by the following example which compares how much a state would receive from the Federal government if it purchased $1 million in non-expendable personal property each year for 10 years and if it received a flat FFP rate of 50% of the initial cost in the year expended (column 2) as compared with 50% of the depreciation payment (column 3). Column 4 is the result of subtracting column 3 from column 2 which the State claims is the added cost to a state if it does not receive a flat FFP rate:

"Comparison of Federal Match Received from a 'Normal Payback' Versus 'Depreciation Payback'"

"Fiscal Year	Normal Payback (1)	Depreciation Payback (2)	Variance
1977	$500,000	$ 50,000	$ 450,000
1978	500,000	100,000	400,000
1979	500,000	150,000	350,000
1980	500,000	200,000	300,000
1981	500,000	250,000	250,000
1982	500,000	300,000	200,000
1983	500,000	350,000	150,000
1984	500,000	400,000	100,000
1985	500,000	450,000	50,000
1986	500,000	500,000	-0-
		Total Variance (3)	$2,250,000"

"Notes

(1) Assumes a flat 50% FFP and annual equipment expenditures of $1 million. The normal FFP rate is normally higher.

(2) Assumes a 10-year-life for all equipment. In actual practice it will vary by type of equipment from 5 to 20 years.

(3) The variance represents the added costs to the state agency during the first ten years if 45 CFR 205.160 is not withdrawn." [45 CFR 205.160 is the comparable regulation for the Social and Rehabilitation Service]

The example above is incomplete, however, because it shows only part of the depreciation expenses for the ten years of purchases; for instance, the equipment purchased in 1978 would continue to be available for a depreciation payback through 1987, and 1986 purchases would continue to be available for a depreciation payback through 1995. The example should therefore be continued in the following manner:

Fiscal Year	50% Payback	Depreciation Payback	Variance
1987	0	450,000	- 450,000
1988	0	400,000	- 400,000
1989	0	350,000	- 350,000
1990	0	300,000	- 300,000
1991	0	250,000	- 250,000
1992	0	200,000	- 200,000
1993	0	150,000	- 150,000
1994	0	100,000	- 100,000
1995	0	50,000	- 50,000
		Total Variance (1987-95)	-2,250,000
		Total Variance (1977-95)	0

Thus, at the end of a 19 year period, there would be no added costs for a state if it were to receive a depreciation payback rather than an FFP rate on the whole initial outlay.

In the simpler and more plausible case of a major capital investment of $1 million in the first year of a program only, the variance would also be zero at the end of the estimated useful life of the equipment. Of course, in both the more complicated and the simpler case, the delay in recovery has a financial impact on the State.

In its Issue Paper (page 2), the State characterizes the welfare program as a partnership and argues that in such an arrangement, one of the partners would not be expected to finance at its own expense the costs attributable to the business. All partners would ultimately share in the cost of the assets through depreciation accounting and interest charges. The State argues that since interest and other financial costs are not allowable for reimbursement (see 45 CFR Part 74, Appendix C, Part II, D.7), the depreciation method is harsh. Such a partnership arrangement, however, does not mean that all burdens must be divided equally. The State would surely not support such an argument across the board since it now only pays 25% of most of the costs of the child support enforcement program.

The Board has previously noted that federal grants are not made to reimburse grantees for all expenses but in general will reimburse all costs less an element of cost sharing or local share. "That the rules impose a burden on the grantee does not make the result inequitable provided the burden is consistent with the intent of the program and the stated rules" (Action for Boston Community Development, Inc., Board Decision No. 32, Docket No. 76-4, January 31, 1977, page 3). Cf. LEGIS 50/The Center for Legislative Improvement, Board Decision No. 48, Docket No. 76-17, September 26, 1978, page 7.

The regulation requires FFP for only those costs which the Secretary determines as being proper (45 CFR 304.20(b)). The Secretary has broad rulemaking authority under Section 1102 of the Social Security Act to "make and·publish such rules and regulations, not inconsistent with this Act, as may be necessary to the efficient administration of the functions with which [he] is charged under this act."

The cost of non-expendable personal property is reimbursed at the full 75 percent rate; the Secretary has determined that only a certain amount of the cost may be attributed to certain quarters. Section 455(a)(1) of the Social Security Act does not preclude the Secretary from determining under reasonable rules which costs are properly attributable to which quarters.

Under National Welfare Rights Organization v. Mathews, 533 F.2d 637 (D.C. Cir. 1976), 45 CFR 304.24 is valid if it does not conflict with the Act and is reasonably related to its purpose. When a purchase is made directly by the IV-D agency, there is a built-in assurance that the property will be used for the purpose for which it was intended. When the property is allocated between different organizational elements as part of an indirect cost pool, there is less guarantee that the property will be used for its intended purpose during its entire useful life. Requiring depreciation allows the Federal government to be assured that the property will continue to serve its intended purpose for its entire useful life; this assurance is a sound goal, and the regulation is a rational method by which to achieve the goal.

The State mentions in its application for review that it had been attempting to persuade HEW not to implement the regulation involved in this case and that it appeared that its efforts were meeting with some success. New regulations were promulgated by the Office of Human Development Services on April 5, 1979 on the subject of non-expendable personal property, but they do not amend 45 CFR 304.24 (see 44 FR 20430).

Conclusion

In view of the foregoing discussion, it is our opinion that 45 CFR 304.24 (a)(3) does not contradict the wording of Section 455(a) of the Social Security Act and that the regulation imposes a commonsense method for payment of the appropriate federal share of costs for non-expendable personal property.

Accordingly, we deny the appeals and affirm the disallowances of $820 and $1,255.42. This decision constitutes the final administrative action on this matter.

/s/ Bernard E. Kelly

/s/ Thomas Malone

/s/ Malcolm S. Mason, Panel Chairman