DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Florida Farmworkers Council, Inc. DATE: July 31, 1981
Docket No. 80-127
Decision No. 202

DECISION

The Florida Farmworkers Council, Inc. (FFC) requested review of a July 15, 1980 decision by the Principal Regional Official (PRO), Region IV, Department of Health and Human Services (Agency). That decision, issued under 45 CFR Part 75, upheld the determination by the Director, Division of Cost Allocation (DCA), establishing a final indirect cost rate of 9.5 percent for FFC for the year which ended December 31, 1978.

Our decision is based on FFC's application for review, the Agency's response thereto, a hearing held before the Board, and post-hearing briefs filed by both parties.

Statement of the Case

In January, 1980 FFC submitted an indirect cost proposal (ICP) for the year which ended December 31, 1978. FFC's proposal contained two alternatively proposed rates. The first rate of 19.37 percent was termed applicable to "participating grants." 1/ This rate was computed by excluding from computation grants which had no provisional rate clause. The second rate of 17.57 percent was computed using all grants, and included in the pool costs of overhead paid directly by grants which had no provisional rate clause. See, FFC Application for Review, p. 2.

After FFC's proposal was submitted to the Agency, and as part of the negotiations between the Agency and FFC, the 1978 ICP was audited by the HHS Region IV Audit Agency. The final audit report, Audit Control No. 04-07008, challenged the validity of the two rates proposed by FFC in its ICP.

The auditors questioned the "participating grants" method on the basis that its distribution base was improper. The auditors determined that grants which benefitted from indirect costs were not included in the base and, therefore, did not receive a proportionate share of the indirect costs.

1/ FFC now states that this approach was compiled for illustration purposes only and is no longer argued for acceptance as a final rate. See, FFC Post-Hearing Brief (hereinafter cited as Brief), p. 3.

The auditors agreed with FFC's "all grants" approach to the extent that it included in the distribution base the total direct costs of all FFC grant programs. See, Agency Brief, p. 13. The auditors did, however, take exception to the reclassification of costs associated with FFC's vice presidential and accounting tiers of personnel for purposes of computing the rate (See p. 3 for further discussion). The auditors determined these costs were direct as defined in 45 CFR Part 74, Appendix F. 2/

After negotiations failed to produce an agreement as to the appropriate final indirect cost rate, the Director, DCA, issued a decision establishing the final indirect cost rate as 9.5 percent. Pursuant to the informal appeal procedures at 45 CFR Part 75, FFC appealed this determination to the PRO. On July 15, 1980 the PRO affirmed the decision of the Director, DCA.

By letter dated August 11, 1980, FFC appealed the PRO's decision to this Board pursuant to 45 CFR Part 16.

Discussion

FFC has presented alternative arguments, either of which, if accepted, would result in a higher rate than that determined by the Agency. The first argument promotes FFC's so-called "all grants" approach. The second addresses the adjustments made in the HHS Audit Report. For purposes of the second argument, FFC does not propose to reclassify direct costs associated with its vice presidential and accounting tiers of personnel as indirect for rate computation purposes.

Issue #1. Whether the Methodology of the "All Grants" Approach Is Correct

FFC allegedly had some grants that reimbursed indirect costs through use of an indirect cost rate and other grants that required all costs to be directly charged. See, generally, Transcript of Hearing January 14, 1981 (hereinafter cited as Tr., Jan. 14), pp. 93-96. FFC contends that the "all grants" approach is an equitable method of distributing costs among all its grants so that FFC is reimbursed for all allowable, reasonable, and allocable costs, some of which would not otherwise be reimbursed because of the inconsistent grant provisions concerning recovery of indirect costs.

2/ The cost principles contained in OASC-5, A Guide for Non-Profit Institutions, which were cited by the auditors, are set out in 45 CFR Part 74, Appendix F (1978). For convenience we cite to the regulations.

FFC's proposed solution was an analysis of direct costs (particularly staff salaries of its three tiers of administrative personnel) without regard to how the salaries were to be budgeted, to determine where the staff actually spent its time; FFC argued this would produce an equitable distribution of indirect costs. Id. at pp. 98-107. The process of analyzing these costs was described by FFC's witness at the hearing, a certified public accountant, as follows:

> [W]e started with the salaries of the people we considered probably includable within the indirect cost pool, and we created, in effect, three tiers of people. The first tier is equivalent to the president 3/ of an organization.... They benefit everybody.
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> The second tier is what we all say is the equivalent of a vice president, and like in any business, a vice president cannot be involved with everything. There is just a limit as to how far he can stretch his duties. We accordingly, then, went through each individual grant ... and determine [sic] which person in that program was in fact functioning in that capacity. Accordingly, we go through the Head Start grant and pick out the chief administrative person in charge of that grant. In Head Start that person had been charged as a direct cost to that program, but they were functioning at the administrative level of vice presidency. We go through all the CETA grants and the other and pick up the equivalent person so we would end up with a complete second tier which basically represents the listing that we are calling administrative personnel.
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> The third category of people is the accounting department. That department benefits the entire accounting system, and accordingly, they are also included in the administrative category.... Id. at p. 103.

FFC argues that this method of reassigning or reclassifying direct costs associated with FFC's "vice presidential tier" 4/ of employees as indirect results in an equitable distribution of costs. FFC Brief, p. 4.

3/ It is not clear from the record whether or not salaries of the "presidential tier" are included in the disputed costs. Neither party has presented arguments addressing the "presidential" salaries. Therefore, we assume they are not included in the disputed salaries and render no judgment on them.

4/ The general arguments of both parties concerning the "all grants" method refers only to the "vice presidential" tier. However, it is clear that the salaries of the third tier, the accounting department, are included among the disputed reclassified costs. See, generally, Tr., Jan. 14, pp. 138-140, 147. These are discussed separately below.

In support of its reclassification of costs under its "all grants" approach, FFC contends that there is precedent for the viewing of certain costs billed directly as indirect for rate computation purposes. FFC notes that the so-called Kirschenmann memorandum 5/, Government Exhibit No. 3, authorizes the viewing of direct costs as indirect for rate computation purposes when computing a rate for Community Services Administration "01" budget accounts. FFC Brief, p. 5. FFC argues that the rationale of the Kirschenmann memorandum was extended to apply to other grants by the Board decision in Economic Opportunity Corporation of Greater St. Joseph, Decision No. 45, August 29, 1978. Id. at p. 5.

FFC also argues that the reclassified costs should be allocable to all FFC grant programs, because the "all grants" approach produces an "equitable relationship" of costs among the various grants in accordance with Appendix F. FFC Brief, pp. 6-7. FFC concludes that the evidence shows that general cost equity is achieved by the reclassification and, therefore, the "all grants" technique is a valid method of computing an indirect cost rate. Id. at p. 11.

The Agency argues that Department regulations require that costs are to be allocated only to those cost objectives which benefit from the incurrence of such costs. Agency Brief, pp. 6-7. The Agency contends that HHS auditors found certain costs allocable to one grant and as such charged those costs directly to the respective cost objective. Id. The auditors found other costs which, although benefiting more than one grant, did not benefit the programs in general. Their duties were found to be limited to specific programs and, thus, were not allocable to all FFC programs. Id. at pp. 7-8. The Agency argues that FFC's reclassification of costs associated with the "vice presidential" tier does not result in an equitable distribution; on the contrary,

5/ Memorandum dated September 23, 1975, from Director, Division of Financial Management Standards and Procedures, OASC, to Assistant Regional Directors for Financial Management. The memorandum provides a procedure for computing indirect cost rates for Community Action Agencies which have their administrative costs reimbursed directly through an "01" program account. The "01" program account is described in more detail on page 11. The purpose of the computation is to prevent the duplication of recovery by removing the administrative costs funded by the Community Services Administration from the indirect cost pool and a proportionate amount of direct costs from the distribution base.

the Agency argues, since the staff activities could be identified with specific projects, FFC's reclassification of costs results in an inequitable distribution by shifting costs to programs which do not benefit from such costs. Id. at p. 14.

The applicable cost principles (45 CFR Part 74, Appendix F) contain four interrelated concepts labeled "direct costs," "indirect costs," and "allocability" (the latter term used similarly, but not identically, in two different contexts). These deceptively simple concepts overlap in usage and implicitly call for discretion in applying broad standards on a case-by-case basis. The terms may be viewed as part of a progression, which works as follows:

(1) Otherwise allowable costs must be determined to be "allocable" to the particular objects of attention involved — in this case, a number of Federal grants. The first determination concerns whether a particular cost (whether it will ultimately be determined to be direct or indirect) is "assignable or chargeable" to one or more of the grants in question or to some other effort of the organization. The first determination of allocability (another such determination related to indirect costs will be discussed below) is made by looking at "the relative benefits received or other equitable relationship" to the grant(s); a cost may be allocable if it "is incurred specifically for the grant," if it "benefits both the grant . . . and other work and can be distributed to them in reasonable proportion to the benefits received," or if the cost is necessary to the overall operation of the grantee institution and cannot be directly related to a particular cost objective. 45 CFR Part 74, Appendix F, B.4.

(2) Costs which are generally allocable under (1) are determined to be either direct or indirect costs. There is, in effect, a presumption in the regulations that costs which benefit a specific cost objective are to be treated as direct costs, and only the remaining costs are to be given indirect cost treatment. The cost principles say that a direct cost "is any cost which can be identified specifically with a particular cost objective" (Id., C.1.), and "after direct costs have been determined . . . indirect costs are those remaining to be allocated . . . ." Id., D.1. (Emphasis added). With a high enough degree of sophistication in a grantee's accounting system, it is conceivable that all costs could be directly charged. Therefore, the use of indirect costs results in part from a recognition that there is a point at which the amount of work to identify and charge a cost directly is disproportionate with the benefits received.

(3) The cost principles state that an indirect cost is "one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost." Id., D.1. As stated, the indirect costs are those which remain after direct costs are determined.

(4) Finally, we return to the concept of "allocation," this time in the context of allocation of the indirect costs. The cost principles state that the objective of the process of allocating indirect costs is "to distribute the indirect costs of the institution to its various major activities or cost objectives in reasonable proportions with the benefits provided to those activities or cost objective (sic)." Id., D.1.

It is important to understand the foregoing four elements because the record indicates some confusion about them, particularly as regards the interrelated use of the concept of allocability in two contexts, and the relationship of direct to indirect costs, where direct costing is effectively favored.

Since the reclassified salaries were at one time labeled and claimed as direct costs by FFC and would, therefore, appear to be readily subject to treatment as direct costs, FFC may fairly be charged with the obligation to show that (1) the cost of these individuals benefited a wide range of programs, and (2) that the benefit cannot reasonably be measured by direct costing. See, generally, Tr., Jan. 14, pp. 202-208. FFC acknowledged this responsibility. Id. at p. 203. The Board concludes that, based on the evidence in the record, FFC has failed to justify indirect cost treatment for the costs generally in question in the "all grants" approach.

The auditors in addressing the reclassified salaries concluded:

> Our review disclosed that the duties and responsibilities of these personnel were not involved in administering overall FFC operations. Rather, their duties and responsibilities were limited to specific programs; therefore, their salary costs are not allocable to all programs at FFC.
> Audit Report, p. 2 of Schedule A, Note 1.

Except for conclusory statements, FFC's only attempt to show the wide range of benefit of the "vice presidents", and therefore the indirect nature of these costs, was through testimony of the Director of FFC. See, generally, Tr., Jan. 15, pp. 154-162. The Director testified that the duties of the "vice presidents" were administrative in nature and this administrative function related to a number of grants within FFC. Id.

But the unpersuasive nature of the Director's testimony can be seen in the Director's responses when asked to name the grants upon which each of the individual "vice presidents" exercised his administrative responsibilities. In each case, the Director was able to identify specifically the name and number of the grants, and none of the vice presidential duties associated with these grants represented organization-wide responsibilities. Id. The Director identified the specific cost objectives to which the cost of each of the "vice presidents" could be charged. This showed that the "vice presidents" were clearly associated with specific FFC programs. As was stated on page 6, these costs were at one time claimed as direct costs, and FFC has not shown why, given that the "vice presidents" were associated with specific FFC programs, that indirect cost treatment was proper.

FFC's argument that the reclassification achieved an "equitable" distribution and that the costs benefited numerous grants also is made up of no more than conclusory statements. FFC Brief, pp. 5-6, 8. There is no substantial evidence in the record that these "vice presidents" benefited a wide range of grants. Based on the lack of any showing that the costs could not be reasonably allocated directly, and on the evidence that FFC at one point was able to direct cost the vice presidential salaries, we find this argument to be unpersuasive.

FFC's sole evidence purporting to show the wide range of benefit of the third tier, the accounting department, was through the testimony of its CPA. See, generally, Tr., Jan. 14, pp. 103-104, 138-140. The CPA testified that the accounting department "benefits the entire accounting system, and accordingly, they are also included in the administrative category." Id. at p. 103. The CPA based this determination on observation of daily work routines and dealings with the accounting personnel on a day-to-day basis. Id.

The CPA's testimony concerning the accounting personnel is completely conclusory. No attempt is made to show the wide range of benefit of their individual services; it is simply stated as such. Id. The Board finds such conclusory statements unpersuasive, especially in light of FFC's obligation to show that these costs benefit a wide range of programs, and that the benefit cannot reasonably be measured by direct costing. See, generally, Tr., Jan. 14, pp. 202-208.

Assuming the correctness of FFC's argument that the Kirschenmann memorandum, as allegedly extended by Economic Opportunity Corporation of Greater St. Joseph, is a basis for viewing certain costs billed directly as indirect for rate computation purposes 6/, the Board

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6/ The Board makes no determination in this Decision as to the validity of this argument.

finds that FFC's argument would still fail as applied to the facts of this case. As FFC recognizes in its Brief, the Kirschenmann memorandum is to be applied to indirect costs which have been charged directly but are properly classified as indirect. FFC Reply Brief, p. 6. Since the Board has determined that the costs in question should not have been included in the general indirect cost pool but should have been charged directly, the Kirschenmann memorandum would not apply.

FFC also argues that its reclassification produces an equitable relationship of costs among the grants and, therefore, comports with the allocability requirements of the cost principles. The Board finds that since FFC has been unable to show that the costs of its "vice presidents" should be indirect, FFC's method is not an equitable distribution since it would effectively result in direct costs being allocated to grants which do not benefit from the particular costs. Such a result would conflict with the applicable cost principles. See, 45 CFR Part 74, Appendix F, D.1.

In addition, FFC argues that the programs it administers are subject to the statutory mandate of the Economic Opportunity Act of 1964, as amended, 42 USC §2701 et seq. (EOA). As such, the Agency is required "to assist in combining and coordinating FFC's grant activities." FFC Brief, p. 10. This requirement, FFC contends, is a legislative acknowledgement of the mutual benefit of combining grant programs and that such an acknowledgement implies that such programs benefit each other. In light of the allocation provisions in 45 CFR Part 74, Appendix F, FFC states that:

> It seems logical that if Congress decrees there is a common benefit received among programs that it cannot be fairly said that work confined to say, six of FFC's training programs, is of no benefit to FFC's child care grants, or vice versa. FFC Brief, pp. 10-11.

The Board does not agree that any work done by an employee of one grant must necessarily benefit all the grants. Such a benefit is purely incidental and its extent a matter of speculation. FFC has made no attempt beyond a description of the interrelationship of grant programs (See, e.g., Tr., Jan. 14, p. 118) to prove that an actual benefit exists and that the use of the interrelationship concept as a basis of allocation would result in a distribution of costs to the cost objectives in reasonable proportions with the benefits provided to those cost objectives. See, 45 CFR Part 74, Appendix F, D.1. Without such a showing the Board is unable to accept FFC's contention. Furthermore we do not read the quoted section of the Economic Opportunity Act to require the abandonment of the long-standing and reasonable rule favoring direct costing.

Issue #2. Whether the Auditors' Adjustments Are Correct

FFC argued that if its "all grants" method is rejected, then a detailed examination of cost items leads one to conclude that FCC's proper ICR should be higher than that decided on by the Agency. We agree, in part.

To support its case FFC used the general method employed by the Agency to compute an ICR and individually addressed the adjustments recommended by the auditors and accepted by the Agency in establishing FFC's final rate. Our analysis follows FFC's order of presentation.

a. Adjustment to Total Direct Cost Base

FFC argues that it operated as a "conduit" organization for $420,000 provided to the State of North Carolina and that virtually no administrative costs were associated with the transaction. FFC submitted affidavits attesting to the lack of administrative effort involved in acting as a conduit in this arrangement. See, FFC Supplemental Filing. FFC argues that since no indirect or overhead cost was incurred under this arrangement, the total direct cost base should not reflect the inclusion of the $420,000.

The Agency earlier contended that the factual situation surrounding the "conduit" arrangement was not disclosed by FFC's CPA in the indirect cost proposal. Agency Brief, p. 19. In response to FFC's supplemental submission, the Agency later stated that there appears to be little administrative effort connected with the "conduit" arrangement and, therefore, "[i]t appears that it would be appropriate to exclude the $420,000 from the indirect cost allocation base for indirect cost rate computation purposes." Agency Response to FFC's Supplemental Filing.

Based on the evidence in the record, the Board finds that the $420,000 should be subtracted from the base. FFC has shown, and the Agency has conceded, that at most one person-day of effort was spent administering the conduit arrangement. 7/ It would be contrary to the cost principles to allocate indirect costs to a cost objective which did not benefit from those indirect costs. 45 CFR Part 74, Appendix F, B.4.

7/ The Agency has not argued that the administrative effort of a one person-day should be calculated and a corresponding amount of the $420,000 be included in the base. Therefore, the Board agrees that the entire amount should be excluded due to the de minimus effort associated with a one person-day.

b. $37,480 of Allegedly "01" Funds

The auditors recommended an adjustment of $37,480 8/ which they found to be indirect in nature; however, since FFC had previously billed for this amount as a direct cost the auditors excluded it from the indirect pool to avoid a duplicate billing. The Director, DCA, found the costs were direct and refused to apply the Kirschenmann memorandum.

FFC argues that the $37,480 are indirect in nature. In addition, FFC argues that since these funds were paid directly through the "01" account under a Community Services Administration (CSA) grant, the indirect cost rate should be calculated in accordance with the Kirschenmann memorandum. FFC contends that this would result in an increase of its ICR of about 1 percent. FFC states that the Board should reject the DCA Director's decision not to apply the Kirschenmann memorandum because his testimony was contradictory and contrary to OASC-5 and the Kirschenmann memorandum itself in that both documents require the formula to be applied to "01" accounts without exception.

The Agency argues that the $37,480 was appropriately classified by the auditors as indirect costs for CSA. The Agency notes that this classification was made without benefit or consideration of any "01" funds under the CSA grant. See, Agency Brief, p.20. With regard to the application of the Kirschenmann memorandum, the Agency argues that based on the testimony of the Director, DCA, and the award documents, there is some question whether FFC qualifies as a Community Action Agency (CAA) and, therefore, there is a question whether or not the memorandum should be applied. Id. at p. 16.

8/ FFC contends that the actual "01" figure is $40,876, and that the Agency's primary auditor did not dispute this in his testimony. FFC Brief, p. 15. The auditor's testimony cited by FFC was in response to a request by FFC's counsel to hypothetically apply the Kirschenmann memorandum to the $37,480 figure. See, generally, Tr., Jan. 15, pp. 90-98. The auditor was not specifically asked to address the correctness of the $40,876 figure. He simply stated that the figures are essentially the same, except that FFC's CPA identified $2,300 more of administrative costs. Id. at p. 95. This does not amount to an admission by the auditor to the correctness of the $40,876 figure. Therefore, since the auditor did not attest to the correctness of FFC's $40,876 figure, and FFC has made no attempt to verify it, the Board finds that the auditor's figure of $37,480 is the appropriate figure for purposes of this adjustment.

The "01" account is a program account designation used in the CSA grants whereby funds are provided to CAAs to pay for general administrative costs. See, generally, OASC-5, Sec. I, p. 5. This is done to minimize the amount of costs treated as indirect. Id.

The evidence presented by the Agency on this issue is conflicting. The auditors determined the $37,480 to be indirect in nature, while the Director, DCA, who has ultimate responsibility for deciding whether or not the Kirshenmann memorandum is to be applied (See, Tr., Jan. 15, p. 94) testified that he "did not agree with the auditor that [the $37,480] were properly classified as indirect-type costs." Id. at p. 125. With regard to the question of whether or not the $37,480 was funded through an "01" account, the DCA Director's testimony was conflicting. The Director first testified that the Regional Director of CSA in Region IV informed him that there was no "01" account in the budget. See, Tr., Jan. 14, p. 76. Under later questioning, the Director testified that it was his understanding that the $37,480 was budgeted and expended under an "01" account. Id. at p. 127.

The Agency's argument that FFC does not qualify as a CAA and, therefore, the Kirschenmann memorandum is not applicable also conflicts with the testimony of the Director, DCA. The Director testified:

> Well, that [the Kirshenmann memorandum] was designed to accommodate the payment of a lot of indirect costs as direct and primarily for the Community Services Administration, but we haven't always restricted the use to CAP [CAA] agencies.

Tr., Jan. 14, p. 177.

In view of the persuasiveness of FFC's argument and the conflicting evidence presented by the Agency, we find that the $37,480 to be indirect in nature, and that the computation of the rate should be in accordance with the Kirschenmann memorandum.

c. Whether $22,325 Was Applicable to Specific Programs

The auditors recommended an adjustment reclassifying $22,325 as a direct cost. Audit Report, Note 1 of Schedule A, p. 2. The auditors determined the costs to be "applicable to specific programs" and chargeable therefore "as a direct cost." Id.

FFC contends that salaries of $20,633 and fringe benefits of $1,692 were incorrectly reassigned from indirect to direct. FFC notes that the salaries and fringe benefits represent portions of salaries of three

employees (Manpower Coordinator, Youth Coordinator and Energy Coordinator) listed under Item - Number 1, in the Addendum to Negotiation Agreement, Tab 1 of the administrative file. FFC Brief, p. 27. FFC argues that the Addendum refers to FFC officials whose time was considered indirect and, therefore the costs have already been approved as indirect via the Addendum. Id. at pp. 27-29.

The Agency does not dispute which employees' salaries and fringe benefits are represented by the $22,325, See, Agency Brief, p. 24, but argues generally that the salaries and fringe benefits are direct costs as was determined by the auditors. Id. at pp. 24-25. In addition, the Agency states that FFC did not have a labor distribution system, as required by the regulations, to provide documentation to support the charging of these individuals as indirect costs. Id. at p. 25.

The Agency has not addressed FFC's main argument regarding these costs, that the Agency itself has recognized the indirect nature of the costs in Region IV's final rate decision. See, Tab 1 of the administraive file.

The Negotiation Agreement represents the final rate determined by the Director, DCA. See, Tab 1 of the administrative file. The Addendum sets out the administrative people identified in the proposal, and the percentages of time determined to be appropriately chargeable as indirect costs. See, Tr., Jan. 14, p. 228.

Since the Director, DCA, determined that these costs are indirect, and the Agency has failed to show otherwise on appeal, we conclude that the salaries and fringe benefits should be included in the indirect cost pool.

Neither party has discussed in any detail the issue of whether FFC had a labor distribution system. We note that the Director, DCA, was able to determine the indirect nature of a portion of these salaries. Without a contrary showing by the Agency, we assume that documentation existed showing the indirect nature of these costs.

d. Whether the Base Should Reflect In-Kind Contributions

The auditors recommended treating as direct costs $69,564 attributable to in-kind matching contributions provided (or required to be provided) by FFC during 1978. Audit Report, Exhibit A, p. 2. The contributions were made up of $51,369 applicable to a Community Services Administration Grant, and $18,195 applicable to two grants of the National Council on Aging. Id. The adjustment was based on 45 CFR Part 74, Appendix F, G.9(b), which states:

> . . . the fair market value of donated services or goods utilized in the performance of a direct cost activity . . . shall be considered in the determination of the indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of indirect costs.
> Id.

FFC has not challenged the Agency's reading of the quoted cost principle; rather, FFC makes two collateral arguments.

FFC's first argument is that the HHS provision is superseded by allegedly contrary provisions of Office of Management and Budget (OMB) Circular A-122. FFC Brief, pp. 20-26. The pertinent provision of A-122 is essentially the same as the section of 45 CFR Part 74 quoted above, but adds that in-kind contributions of services shall be allocated a proportionate share of indirect costs --

> . . . when the following circumstances exist:
> (a) The aggregate value of the services is material;
> (b) The services are supported by a significant amount of the indirect costs incurred by the organization;
> (c) The direct cost activity is not pursued primarily for the benefit of the Federal Government. (Paragraph 10.a.(2)).

A-122 was issued June 27, 1980 (45 F.R. 46022, July 8, 1980), and contains a provision (Paragraph 2) stating that the Circular "supersedes cost principles issued by individual agencies." Paragraph 9 of the Circular states:

> Effective Date. The provisions of this circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions is also permitted by mutual agreement between an organization and the cognizant Federal agency.

FFC argues that the foregoing phase-in provision --

> . . . fails to address a situation such as . . . in this case -- i.e. a rate determination involving many grants and subgrants. It fails also to address the situation in this case where each grant FFC received had different cost standards because no uniform cost rules applied to non-profits prior to the promulgation of A-122. FFC Brief, pp. 22-23.

Thus, argues FFC, A-122 should apply "immediately." The Board disagrees with FFC's position for the following reasons:

- While one may, as FFC argues, find some scant support in case law for allowing the retroactive application of administrative rules, we need not reach that issue as A-122 has a clear provision in Paragraph 9 providing for a phase-in of the Circular. Paragraph 9 can easily and reasonably be interpreted to apply to this case, since the grant awards in question could be considered either existing grant awards or awards for which FFC asks that there be "earlier implementation" of A-122. The Circular does not distinguish between the myriad of types of dealings one may have under grant award, and so contains nothing that would require special treatment of a rate determination *per se*. On the other hand, FFC's position would require a much more attenuated interpretation of the Circular. Paragraph 9 apparently deals with special circumstances by leaving it to Agency discretion whether to apply A-122 to matters arising under existing or past grant awards. There is no evidence or even allegation in this case of any arbitrary Agency refusal to consider such an approach here.
- Merely because there might be "many grants and subgrants" does not mean that the scheme in Paragraph 9 is not, or should not be, applicable. Furthermore, at least as regards the in-kind contributions (and FFC makes its A-122 argument only in connection with the in-kind contributions portion of the dispute) there are few grants involving only two agencies.
- While each grant FFC received may have had "different cost standards" as FFC argues (there is nothing substantial in the record to indicate one way or the other), there have been nothing more than conclusory statements that FFC somehow ran afoul of differential standards concerning the reclassification of in-kind contributions.

Furthermore, even if A-122 were applied, it would not lead us to hold for FFC. FFC notes that Paragraph 10.a.(2) of the Circular provides that in-kind contributions only have to be included in the direct cost base were the aggregate value of the services is "material."

FFC argues that since the value of the in-kind contributions ($69,564) is less than 2% of total Federal costs, it is not "material." As the Agency points out, however, it is unreasonable to relate the in-kind contributions to total overall costs, since the in-kind contributions were used only for certain specified grants, and could not be "double-counted" for any other grants. Agency Brief, pp. 22-24. Thus, the

in-kind contributions should be weighed against a much smaller group of costs, and would yield a higher degree of significance (perhaps as high as 40%, according to the Agency). Id. at p. 23. Even if it did not, we would not be inclined to lightly find that almost $70,000 in in-kind contributions, even if it were expressed as only 2% of some larger pool of overall cost, was immaterial or otherwise was reflective of an insignificant amount of indirect costs; there is considerable room for Agency discretion here in determining what is or is not immaterial or insignificant.

FFC also argues that, since under 45 C.F.R. 74.4 inconsistent terms of a particular grant agreement supersede Part 74 and its appurtenences such as OASC-5, it is unreasonable to apply Part 74, Appendix F to the grant of the Community Services Administration, which calls for a specific amount or percentage of match; FFC alleges that transferring the in-kind contributions could indirectly cause FFC's required match to exceed the amount specified in the grant agreement with CSA. This position, of course, appears highly speculative in the context of the evidence and submissions of FFC and the Agency, from which, despite the many opportunities to present evidence and argument in this case, we cannot definitively determine the precise nature of the FFC matching obligation to CSA, whether FFC has fully met its matching obligation or not, and how, if at all, the transfer would affect the match. We do agree in principle that FFC cannot, based on anything in the record before us, be compelled to contribute any more to the CSA project than the amount, if any, specified as its matching obligation; we leave it to the Agency to assure that its computations reflect this limitation.

FFC also argues, in order to comport with Paragraph 10.a.(2)(c) of A-122, that its costs are "pursued entirely for the Federal Government since they are wholly related to fulfilling federal grant performance." FFC Post-Hearing Brief, p. 24. This argument approaches absurdity, since its logical extension is that all Federally-assisted activity under any grant is "pursued entirely for the Federal Government," thus rendering the provisions of Paragraph 10.a.(2) meaningless. The authors of A-122 clearly meant to distinguish between most assisted activities - which are primarily for the benefit of some segment of society - and activities which specifically benefit the Federal government per se.

e. Whether the Legal Fees Should Be Included in the Pool

The auditors recommended reclassifying as direct costs $15,197 in legal fees which had been claimed by FFC as indirect costs. The auditors recommended both that the fees be considered unallowable (as representing

prohibited claims against the Government) and that the fees be transferred to the direct cost base (because they were identifiable with a particular program). Audit Report, Schedule A, p. 3.

FFC argues strongly that the costs did not involve prosecution of claims against the Government. FFC Brief, pp. 29-32. The Agency agrees that "the issue is one of allocation as opposed to allowability", Agency Brief, p. 25, and addressed its post-hearing argument solely to allocation. Id. at pp. 25-26. The Agency position is that the legal costs are identifiable directly with activities related to one or more Department of Labor grants, and therefore the costs should be a direct cost chargeable to the Department of Labor and not an indirect cost chargeable to other agencies as well. Id. at p. 25.

FFC does not deny that the legal fees in question were incurred in connection with activities directly involving the Department of Labor. FFC Brief, pp. 29-32; Tr., Jan. 15, p. 71. The legal work dealt with continued eligibility for Labor Department funds and "a matter involving FFC's corporate records" (i.e., legal representation in connection with Labor Department audits and with a grand jury subpeona of FFC records related to a Labor Department grant). Id. at p. 32; Tr., Jan. 15, p. 71.

FFC's primary argument in support of its position that the legal fees are appropriately assignable to indirect costs essentially is that the fees were necessary for the overall operation of the "business" of the grantee (FFC's "trade" being that of a federal grantee). FFC Brief, pp. 32-35. Since FFC's "trade" is that of a Federal grantee, it engages legal fees in connection with activities allegedly necessary to its overall operation such as negotiation over records availability for audits and maintaining eligibility for grant funds of the Department of Labor. FFC argues at length in support of its argument the case of TRW Systems Group of TRW, Inc., ASBCA No. 11499, July 11, 1968, 68-2 BCA, CCH 7117. 9/ That case involved the issue whether a contractor could allocate to its various government contracts on a pro rata basis the costs of its patent program, under which employees were given various incentives for patents which, in turn, indirectly benefited government contracts. An element at issue was the meaning of Armed Services Procurement Regulations (ASPR) 15-201.4, "Definition of Allocability," which defined a cost as allocable if, among other things, the cost "is necessary to the overall operation of the business, although,

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9/ The Agency did not respond to this argument of FFC.

a direct relationship to any particular cost objective cannot be shown." This definition is virtually identical to that contained in the HHS cost principles. See, 45 CFR Part 74 Appendix F, B.4. The Government read the provision narrowly to require a showing that the cost is necessary to permit day-by-day operation of the business during performance of the government contracts. The Armed Services Board of Contract Appeals (ASBCA) found this reading too narrow, and said that the ordinary meaning of the words of the ASPR provision also included consideration of elements needed for the continued and future operation of a business. The ASBCA also went on to point out that merely because an expense is "necessary" to continued operation does not mean it automatically also meets the additional requirement of ASPR 15-201.4 (and also of Appendix F) that the cost "benefit" the contracts (or grants) in question; there may need to be additional evidence of "benefit":

> . . . scope must be given to the element of a "benefit or other equitable consideration" when determining the allowability of a necessary cost under ASPR 15.20.4(iii). Expenses which are absolutely necessary for the operation of a business are, for that reason alone, beneficial to or bear an equitable relationship to Government contracts. As the absolute necessity decreases, the contractor's burden to show some benefit or other equitable relationship with Government contracts increases. Id. at p. 32967 (emphasis added).

The ASBCA then went on to a detailed examination of the patent costs in question, granting the contractor's claim for a portion and denying a portion.

We note an important difference between the circumstances in the TRW case and in the instant case. In TRW, the question appeared to be whether the costs in question could be allocated to certain Government contracts at all; the issue was one of allocability in terms of allocability to the federal contracts per se, and thus was a question related to allowability or the initial allocability determination (See discussion above on page 5; one may incidently note the Board's use of the term "allowability" in the material quoted above, which FFC also quoted). In the case before us, allowability effectively was conceded by the Agency; the question is which of the Federal grants should bear the costs. Stated another way, in TRW, the question appeared to be whether there was any allocability to Federal cost objectives at all, whereas here the question is whether only one, or more than one, Federal agency should receive the allocation. In circumstances perhaps more analogous to those here, there is also a case in which the ASBCA determined that costs should not be subsumed in a general and administrative

expense pool when those expenses were incurred wholly in connection with the performance of a particular contract, for this would unfairly burden other contracts; thus, legal expenses incurred solely in connection with a single contract might be costed directly to that contract. Allied Materials and Equipment Co. Inc., ASBCA No. 17318, 75-1 BCA 11,150 (1975).

At the same time, it is true that legal fees related to the general performance of contracts can be chargeable as indirect costs. Hayes International Corp., ASBCA No. 18447, 75-1 BCA 11,076 (1975). It is important to observe the distinction between the case before us and the TRW case cited by FFC because once one goes beyond the definition of allocability per se as discussed in the TRW case, one finds an additional (albeit similarly ambiguous) statement of what is required of an indirect cost in Appendix F, D.1:

> An indirect cost is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost . . . the overall objective of the allocation process is to distribute the indirect costs of the institution to its various major activities or cost objectives in reasonable proportions with the benefits provided to those activities or cost objective. (emphasis added)

In this context, we do not think the rule FFC selects from the TRW case - that the "necessity" of a cost may translate ipso facto into its allocability - can be read to apply as directly to the question of allocation to direct vs. indirect allowable costs, as it did to the question of allocation to Federal vs. non-Federal objectives. The "necessity" of the costs to FFC does not by itself mean that the costs should be treated as indirect costs under the TRW case, and under the rule applicable to indirect costs, it is clear that the costs are "readily subject to treatment as direct costs," since they are very specifically identifiable with grants of the Department of Labor.

FFC argues that the costs in question should be placed in the indirect cost pool because it is necessary for the operation of FFC to maintain its eligible status for all Federal funding. But FFC has made no showing that it is necessary for its operation that it receive specific grants from the Department of Labor; presumably, FFC could exist as a Federal grantee with or without the Labor grants, as long as it had other Federal grants. FFC has made no showing that ineligibility for the Labor grants would have put them out of business on other grants.

FFC also argues that certain of the legal fees should be treated as analogous to cost of grant proposals, which may be treated as part of the indirect cost pool under the cost principles. See, 45 CFR Part 74, Appendix F, g. 3. That section defines bidding or proposal costs as "the immediate costs of preparing . . . applications for financial assistance . . . ." The record nowhere indicates that the fees in question here included "the immediate costs of preparing" grant applications. FFC's own presentation clearly indicates that while certain of the negotiations involving legal counsel concerned prospective arrangements under hoped-for new awards by the Department of Labor, these negotiations occurred in the context of litigation and dealings with the Department of Labor and the State of Florida, all of which directly or indirectly concerned performance of FFC under prior Labor awards.

FFC also argues that each new grant it receives benefits all grants, since the costs of administration of each grant go down as costs are spread further. While that generally may be true, it has little to do with resolution of the issue here. It merely is a reason why the cost principles provide for indirect cost treatment for the costs of application preparation.

Finally, FFC argues that the legal fees should be treated as indirect costs to comport with the Economic Opportunity Act of 1964, as amended, which we discussed above in connection with another part of this case. FFC argues that since the Act mandates undertaking activities in a way which will encourage combinations and encourage efficiency in administration, it follows that the legal fees here should be treated as indirect costs so that all programs share. That argument, however, appears to go to the validity of direct costing altogether; we do not read the Act to require an agency to avoid direct costing items which can clearly be identified with a single "benefitted" program.

Based on the foregoing, we conclude with regard to the facts presented in this appeal, that the auditors correctly called for reclassification of the legal fees as direct costs.

Conclusion

Based on the foregoing discussion, this case is remanded to the Agency for recalculation of the FY 1978 indirect cost rate in a manner consistent with the decisions herein. In summary, we find as follows:

Reclassified Salaries Under the "All Grants" Approach:

Agency determination that salaries were improperly reclassified as indirect costs is upheld.

Conduit Principle:

Agency inclusion of $420,000 in base is reversed.

'01' Funds:

Agency determination that $37,480 are direct costs and Kirshenmann memorandum does not apply is reversed.

$22,325 of Salaries and Fringe Benefits:

Agency determination that the $22,325 are direct costs is reversed.

In-Kind Contributions:

Agency inclusion of $69,564 of in-kind matching contributions in the base is upheld.

Legal Fees:

Agency determination that $15,197 in legal fees are direct costs is upheld.

/s/ Cecilia Sparks Ford

/s/ Donald F. Garrett

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