Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Kansas Department of Social and Rehabilitation Services
Docket No. A-03-107
Decision No. 2056

DATE: December 4, 2006

DECISION

The Kansas Department of Social and Rehabilitation Services (Kansas, SRS) appealed a determination by the Social Security Administration (SSA) disallowing $4,923,606 that Kansas claimed for providing disability determination services for SSA for the period October 1997 through March 2002 (fiscal year (FY) 1998 through the first half of FY 2002). SSA disallowed the costs of administrative services that Kansas allocated to Kansas Disability Determination Services (KDDS), the Kansas agency that makes disability determinations required for individuals seeking and receiving Social Security disability benefits under titles II and XVI of the Social Security Act, for which SSA provides 100% funding. SSA determined that Kansas overcharged KDDS for those services because Kansas failed to allocate sufficient costs to other SRS agencies and offices that also received administrative services but received no funding from SSA. SSA also determined that Kansas failed to follow the requirements of its approved cost allocation plan and that it allocated costs in an inconsistent manner that disadvantaged KDDS.

SRS and Kansas Rehabilitation Services (KRS), a division of SRS, provided the administrative services at issue. Kansas argues that it was not required to allocate costs of those services to the other agencies and offices because they received minimal administrative services in comparison to KDDS, and because an amendment to Kansas's cost allocation plan that applied to the costs of KRS services specifically exempted the other agencies and offices from allocation beginning in FY 2000. Kansas also denies that it violated applicable portions of its cost allocation plan or allocated costs inconsistently.

As explained below, we conclude as follows:

- The applicable legal principles required that Kansas allocate the costs of the administrative services at issue to all of Kansas's benefitting offices and agencies in accordance with the relative benefits each office or agency received from the services. Further, Kansas was required to allocate the costs to benefitting offices or agencies based on an approved cost allocation plan free of any material defect.

- To the extent that Kansas's approved cost allocation plan as amended effective for FY 2000 did not allocate any costs of KRS administrative services to particular offices and agencies that benefitted from the services, the approved cost allocation plan appears to contain a material defect. Although Kansas argues that the amount of services provided to the particular offices and agencies was minimal, neither party offered evidence based on which we could reasonably quantify the extent to which the offices and agencies that were not allocated costs derived benefits from those costs, and Kansas did not establish that the benefits were so insubstantial that it would be justified in allocating no costs. Kansas also failed to demonstrate that it had fully informed the Division of Cost Allocation (DCA) of the Department of Health and Human Services, which approved the amended plan in effect as of FY 2000, that the offices excluded from allocation received administrative services from KRS. We are therefore remanding the disallowance of the costs of KRS administrative services for FYs 2000-March 2002 (which we refer to for convenience as FYs 2000-2002) to SSA so that it can confer with DCA about whether DCA considers the approved cost allocation plan amendment to contain a material defect, and if so, to permit Kansas an opportunity to resubmit to DCA a proposed cost allocation plan amendment that can be approved for this period that would fully reflect the relative benefits each office or agency received from the services. If Kansas disagrees with DCA's determinations on any of these remanded issues, it may appeal to the Board within 30 days of receiving any notice of a determination from DCA.

- For FYs 1998 and 1999, the record shows that Kansas did not follow the cost allocation methodology authorized by the approved cost allocation plan for this period, and did not allocate the costs of KRS administrative services to all benefitting offices and agencies in accordance with the relative benefits each office or agency received from the

services. We thus uphold in principle the disallowance of the costs of KRS administrative services for this time period.

- However, SSA's assertion that the cost allocation plan for FYs 1998 and 1999 allocated KRS administrative costs to Kansas offices pursuant to a time study is not consistent with the plan language or audit materials in the record indicating that the plan allocated costs based on the number of employees in the component offices, as Kansas argues. In any event, SSA determined the disallowance for the entire period by reallocating costs based on the number of employees. SSA however counted only administrative or management employees and made its own determination of the number of employees. Kansas argues that all employees should have been included and disputes the numbers used by SSA in its reallocation. Using all employees (rather than just administrative or management employees) is more consistent with the cost allocation plan language and is a common method used to allocate administrative services costs. We are therefore remanding the disallowance of the costs of KRS administrative services for the entire period to SSA so that it can confer with DCA concerning how to implement the plan methodology in a manner consistent with the applicable principles of cost allocation and the language of the plan, including how to determine the number of FTEs from the various KRS components to be counted in the allocation base consistent with the requirements of the cost allocation plan. Since neither party disputes that SRS underwent a reorganization that would affect whether the cost allocation plan method continued to be equitable, DCA may determine that any amended allocation methodology that DCA approves effective as of FY 2000 should also be applied for the earlier period.

- After the consultation with DCA has been completed, SSA may then re-compute the disallowance of KRS administrative costs as follows: (1) SSA may re-compute the disallowance for FYs 2000-2002 applying the terms of either the new plan amendment or the original plan amendment if DCA determines that the latter does not contain a material defect; (2) SSA may re-compute the disallowance for the entire period on the basis of DCA's recommendation concerning how to implement the cost allocation plan methodology in a manner consistent with the applicable principles of cost allocation and the language of the plan (and, if applicable, a determination by DCA that any amended allocation methodology that it approves

effective as of FY 2000 should also be applied for the earlier period).

- If Kansas disagrees with SSA's re-computation of the disallowance, Kansas may appeal to the Board within 30 days of receiving notice of SSA's determination.

- During this process, when SSA consults with DCA concerning any of the issues in dispute between the parties, SSA should provide Kansas with an opportunity to present its position and supporting evidence.

- We uphold the disallowance of the costs of SRS administrative services that SSA determined should have been allocated to State medical institutions.

The record on which we base our decision comprises the parties' briefs and exhibits filed pursuant to 45 C.F.R. § 16.8, and both parties' surreplies. Proceedings were stayed for 22 months for discovery, during which time Kansas moved to compel discovery, SSA opposed Kansas's motion, and the Board issued a request for clarification and a discovery order. Both parties requested and received extensions of time during the briefing process, which lasted over seven months following the completion of discovery.

Applicable law, regulations, and policies

The Act authorizes states, on behalf of SSA, to make disability determinations for individuals applying for or receiving Old-Age Survivors and Disability Insurance (OASDI) and Supplemental Security Income (SSI) benefits under Titles II and XVI of the Social Security Act. SSA pays a state's costs of making the disability determinations, and the state must return any funds provided by SSA that are not used for that purpose. Section 221(a),(e),(f) of the Act (42 U.S.C. § 421(a),(e),(f)).

Regulations governing the administration of the SSA disability determination program provide that states will be reimbursed for their necessary costs in making determinations, including their direct and indirect costs as defined in the Federal Acquisition Regulations at 48 C.F.R., Part 31, Subpart 31.6, and Management Circular A-74-4. 20 C.F.R. §§ 404.1626, 416.1026. Federal Management Circular A-74-4 was reissued as Office of Management and Budget Circular A-87 (OMB A-87), "Cost Principles for State, Local and Indian Tribal Governments." 46 Fed. Reg. 9548 (Jan. 28, 1981). The Federal Acquisition Regulations adopt OMB A-87

for determining the allowability of costs. 48 C.F.R. § 31.602 (1987).

Based on audits arranged by the state or by the Inspector General of SSA, SSA determines whether a state's expenditures for the period for which funds were made available were consistent with cost principles described in 48 C.F.R. Part 31, Subpart 31.6, OMB A-87, and other applicable written guidelines in effect at the time the expenditures were made or incurred. 20 C.F.R. §§ 404.1626(e), 416.1026(e). Disputes concerning final accounting issues which cannot be resolved between SSA and a state are resolved in proceedings before the Departmental Appeals Board under its regulations at 45 C.F.R. Part 16.[1] 20 C.F.R. §§ 404.1694, 416.1094.

OMB A-87 sets out requirements that must be met in order for a cost to be an allowable charge to an award of federal funds.[2] A cost is allowable if, among other things, it is "necessary and reasonable for proper and efficient performance and administration of Federal awards." OMB A-87, Attachment (Att.) A, ¶ C.1.a.[3] In addition, a cost claimed for a federal program is allowable only if it is "allocable" to that program. OMB A-87, Att. A, ¶ C.1.b. A cost is allocable to a particular cost objective (such as a particular program or funding source) if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received. OMB A-87, Att. A, ¶ C.3.a. The Board has repeatedly held that a grantee bears the burden of documenting the allowability of its

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[1] SSA was formerly a component of the Department of Health and Human Services (HHS).

[2] "'Award' means grants, cost reimbursement contracts and other agreements between a State, local and Indian tribal government and the Federal Government." OMB A-87, Att. A, ¶ B.2. It thus includes a state's agreement with SSA to conduct disability determinations, which the Board has held is a contractual relationship rather than a grant. See Arkansas Disability Determination for Social Security Administration, DAB No. 1443 (1993), citing West Virginia Division of Vocational Rehabilitation, DAB No. 869, at 2, n.2 (1987).

[3] OMB A-87 has been revised over the years, most recently in May 2004. 69 Fed. Reg. 25,970 (May 10, 2004). The prior revision was published in 1995. 60 Fed. Reg. 26,484 (May 17, 1995). There are no differences in the applicable portions that we cite in our decision.

claims for federal funding. Nebraska Health and Human Services System, DAB No. 1660 (1998); West Virginia Dept. of Human Services, DAB No. 1107 (1989); 45 C.F.R. § 92.20 (state financial

management systems must adequately identify the source and application of all grant funds and accounting records must be supported by source documentation). Costs must also be accorded consistent treatment. OMB A-87, Att. A, ¶ C.1.f.

The audit report on which the disallowance is based characterizes the administrative costs at issue here as indirect costs. Kansas Exhibit (Ex.) 14. Indirect costs are costs that are: (a) incurred for a common or joint purpose benefitting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. OMB A-87, Att. A, ¶ F.1.[4] One way that state public assistance agencies may claim federal funding for indirect costs is through a public assistance cost allocation plan (CAP), "a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs to all of the programs administered or supervised by State public assistance agencies as described in Attachment D of this Circular [OMB A-87]." Id., ¶ B.17; see also ASMB C-10, ¶ 2.8.2. (ASMB C-10 is an implementation guide to OMB A-87 issued by HHS pursuant to and incorporated in OMB A-87. See, e.g., OMB A-87, Att. E, ¶ A.3. It is titled "A Guide for State and Local Government Agencies: Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government.") States may use CAPs to claim federal funding for the costs of administrative services allocable to programs administered by state public assistance agencies.[5] OMB A-87, Att. D. (The disallowed costs here included the costs of

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[4] Federally-funded programs may also involve direct costs, which are costs that can be identified specifically with the performance of the federally-funded program. KDDS's direct costs would likely include salaries of KDDS employees who make disability determinations and the costs of supplies that KDDS uses for that purpose. OMB A-87, Att. A, ¶ E.1., 2.

[5] Indirect costs incurred by state entities other than public assistance agencies must be charged to federal awards by the use of an indirect cost rate agreement, which may be part of a CAP. OMB A-87, Att. E, ¶¶ A.5, D.1.a. Examples of such costs, called allocated central government services costs, include general accounting, personnel administration, and purchasing. Id., Att. C, ¶ B.2. An audit workpaper indicates that while Kansas used a CAP to allocate administrative costs to DDS, the three other states served by the SSA Kansas City office used indirect cost rate agreements. Kansas Ex. 29.

position management review and processing and human resource management services that Kansas provided to KDDS and other SRS agencies. SSA Ex. C.)

OMB A-87 applies the requirements of 45 C.F.R. Part 95, Subpart E, "Cost Allocation Plans," to all federal agencies whose programs are administered by a state public assistance agency. OMB A-87, Att. D, ¶ A. Part 95 defines a CAP as "a narrative description of the procedures that the State agency will use in identifying, measuring, and allocating all State agency costs incurred in support of all programs administered by the State agency." 45 C.F.R. § 95.505. DCA is the agency responsible for negotiating, reviewing and approving CAPs under Part 95. A state is required to submit a CAP to DCA for approval. 45 C.F.R. § 95.507(a). A CAP must, among other requirements, describe the procedures used to identify, measure, and allocate all costs to each of the programs operated by the State agency; conform to the accounting principles and standards prescribed in OMB A-87 and other pertinent HHS regulations and instructions; and–

> [c]ontain sufficient information in such detail to permit the Director, Division of Cost Allocation, after consulting with the Operating Divisions, to make an informed judgment on the correctness and fairness of the State's procedures for identifying, measuring, and allocating all costs to each of the programs operated by the State agency.

45 C.F.R. § 95.507(a)(1),(2),(4). The CAP must also provide a listing of all federal and all non-federal programs performed, administered, or serviced by the organizational units whose costs are charged to programs operated by the state agency, and a description of the activities performed by each state organizational unit. 45 C.F.R. § 95.507(b)(2),(3).

A state's CAP must also certify that the costs are accorded consistent treatment through the application of generally accepted accounting principles appropriate to the circumstances, that an adequate accounting and statistical system exists to support claims that will be made under the cost allocation plan, that the information provided in support of the proposed cost allocation plan is accurate. 45 C.F.R. § 95.507(b)(8)(ii). In reviewing a proposed CAP or CAP amendment, DCA is directed to consult with the "affected Operating Divisions" (in this case SSA). 45 C.F.R. § 95.511(a).

A state is required to promptly amend its CAP subject to DCA's approval if, among other circumstances, a material defect in the

CAP is discovered by DCA or the state, if the procedures shown in the CAP become outdated because of organizational changes affecting the validity of the approved cost allocation procedures, or if other changes occur which make the allocation basis or procedures in the approved CAP invalid. 45 C.F.R. § 95.509(a). A state may claim federal reimbursement for public assistance program costs only in accordance with an approved CAP, and costs that are not claimed in accordance with the approved CAP or an amendment required by section 95.509 will be disallowed. 45 C.F.R. §§ 95.517, 95.519. See, e.g., Kansas Dept. of Social and Rehabilitation Services, DAB No. 1349, at 6 (1992) (Kansas was on notice that it could claim Title IV-E funding for administrative costs only if they were identified in and allocated according to a CAP approved by DCA).

Background

KDDS, the Kansas agency that makes disability determinations on behalf of SSA, is a component of KRS, Kansas Rehabilitation Services, which is in turn a component of SRS, the Kansas Department of Social and Rehabilitation Services. SRS is "the umbrella welfare and social services agency for the State of Kansas." Kansas Br. at 3. SSA pays 100% of KDDS's costs of making disability determinations, including the costs of administrative services that SRS and KRS provide to KDDS, as they do to other SRS and KRS agencies.

The disallowance resulted from an audit of KDDS's costs conducted by the SSA Office of the Inspector General (OIG). The audit determined that Kansas claimed $4,302,318 for unallowable costs of KRS Central Office services and $621,288 for unallowable costs of SRS Administrative Division services that Kansas allocated to KDDS. In our analysis we first address the disallowance of KRS Central Office costs under Kansas's amended CAP, as in effect for FYs 2000 onward, and under the prior CAP for FYs 1998 and 1999. We then address the disallowance of SRS Administrative Division costs.

Before beginning the analysis we note that Kansas expressed concerns over SSA's motives for conducting the audit. Kansas characterizes the audit as a mission to reduce Kansas's claims and argues that the disallowance, which Kansas calls a pre-ordained result, inconsistently reallocated and improperly shifted costs away from KDDS and onto other Kansas agencies.[6]

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[6] Kansas cites, among other things, an e-mail among SSA (continued...)

Kansas argues that SSA's concern over Kansas's costs compared to other states' indirect costs ignores the cost effectiveness of its disability determination program, which Kansas asserts had average costs per case below the national average.[7] Kansas asserts that some states may have lower rates of indirect costs because they transferred administrative personnel into the disability determination agency where their salaries are considered direct costs.

Kansas's concerns provide no basis for reversing the disallowance. Although SSA did express concern about the rate of Kansas's indirect costs as a percentage of KDDS's personnel costs, which SSA described as unusually high and the second-highest in the nation, that expression provides no basis for questioning the audit finding. SSA's regulations and the cost principles anticipate audits of a state's expenditures for disability determinations and its implementation of its CAP. 20 C.F.R. §§ 404.1694, 416.1094; OMB A-87, Att. D, ¶ E.1. Kansas as a recipient of federal funds is obligated to demonstrate the allowability and allocability of its charges to federal funds and must therefore demonstrate that the costs it claimed from SSA were properly allocable to KDDS, and not to other agencies or programs. SSA's motives in conducting the audit are not germane to whether the audit findings were valid, whether Kansas met its documentary burdens, and whether Kansas claimed funding consistent with the requirements of the cost principles and its CAP or provided accurate information to SSA when it submitted its proposed CAP amendment. See, e.g., American Indian Center of Omaha, Inc., DAB No. 1157 (1990) (regardless of the agency's motives in taking a disallowance, the grantee's obligation to document that grant funds were properly expended remained unchanged); Mississippi Dept. of Public Welfare, DAB No. 700 (1985) (a collateral attack on an agency's audit findings cannot substitute for direct evidence that a state's claims for federal funding were proper).

Conversely, the mere fact that KDDS may have had a higher rate of indirect costs as a portion of personnel costs than the

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[6](...continued)
staff that described Kansas's indirect costs as "outrageous" and stated that the indirect costs "should receive an in-depth review and appropriate action [should be] taken." Kansas Ex. 11.

[7] Kansas notes that the SSA e-mail that described Kansas's indirect costs as outrageous also stated that KDDS "is performing exceptionally well." Kansas Ex. 11.

established indirect cost rates for DDS agencies in other states does not mean that KDDS's indirect or administrative costs were higher. As Kansas argues, this may not be a fair comparison since other states may claim the costs of similar services as direct costs, which would cause them to have lower rates of indirect costs, or may use an indirect cost rate determined using a distribution base other than personnel costs.

The disallowance of KRS Central Office costs allocated to KDDS

SSA disallowed $4,302,318 for costs of KRS Central Office administrative services that Kansas allocated to KDDS for FY 1998 through March 2002, the first half of FY 2002. The KRS Central Office provided administrative services to various KRS offices and staff that provide individuals with rehabilitation services such as vocational rehabilitation and career development, services for visually and hearing-impaired persons, and the disability determination services that KDDS performs for recipients of SSA benefits. The services the KRS Central Office provided included "policy review and oversight;" general management assistance; supervision of program administrators; budgeting and fiscal management and assistance; contract development, review and processing; position management review and processing; and human resource management, review and oversight. Kansas Ex. 14, at 5; SSA Ex. C. SSA determined that the costs of those services that Kansas allocated to KDDS were excessive because Kansas did not allocate any costs to SRS area offices in which KRS staff delivered KRS rehabilitation services or to the KRS Client Assistance Program, a client advocacy and ombudsman office, each of which receives KRS Central Office services. The area offices and the Client Assistance Program do not make disability determinations on behalf of SSA.

SSA argues that applicable cost principles required that Kansas allocate the costs of KRS Central Office services to all benefitting offices, including the area offices and the Client Assistance Program, in accordance with relative benefits received. SSA argues that although Kansas's CAP, as amended effective for FY 2000, excluded the area offices and the Client Assistance Program from being allocated KRS Central Office costs, approval of the CAP did not permit Kansas to claim unallowable costs that did not benefit KDDS and that were allocated to KDDS contrary to the cost principles. SSA also asserts that when Kansas amended the CAP it failed to inform DCA that the area offices and the Client Assistance Program received KRS Central Office services. SSA also argues that the prior version of the CAP that was in effect for FYs 1998 and 1999 required that Kansas

allocate costs to all benefitting offices, including the area offices and the Client Assistance Program. SSA asserts that Kansas's failure to allocate costs to all benefitting offices resulted in Kansas claiming SSA funds for the costs of KRS Central Office services that were not provided to KDDS and were thus not reasonable and necessary costs of performing disability determinations on behalf of SSA.

SSA determined to reallocate the costs to all benefitting offices, including the area offices and the Client Assistance Program, based on what it determined was the number of administrative or management full-time employees, or FTEs (full time equivalents) at the KRS agencies, including KDDS. (The audit report had also determined that Kansas allocated disproportionate costs to KDDS because it allocated costs to KDDS based on the number of all FTEs at KDDS, but to some other KRS offices based only on the number of administrative or management FTEs.) Based on the reallocation, SSA disallowed $4,302,318, the amount by which the costs that Kansas allocated to KDDS (and for which Kansas claimed 100% SSA funding) exceeded the amount that SSA determined was properly allocable to KDDS.

Notwithstanding this reallocation based on FTEs, SSA now argues that Kansas violated the CAP in place for FYs 1998 and 1999 by allocating costs to KDDS based on the number of FTEs because the CAP at that time required that Kansas allocate costs based on the results of a time study. SSA argues that because Kansas violated the requirements of its CAP in claiming federal funds, SSA could have disallowed Kansas's entire claim for KRS Central Office costs for FYs 1998 and 1999. Instead, SSA states, it determined the amount of costs that were not properly allocable to KDDS by reallocating the costs based on FTEs, because this was the method that Kansas employed and because there were no time study data available to reallocate costs according to the requirements of the CAP.

Kansas's primary argument is that the applicable cost principles as applied by Board and court decisions do not require allocation of costs to programs that derive relatively little benefit from the costs, and permit allocation exclusively to programs that primarily benefit from the costs. Kansas asserts that the area offices and the Client Assistance Program "drew very little" on KRS Central Office resources in comparison to the KRS component agencies to which Kansas allocated KRS Central Office costs such as KDDS, which Kansas asserts made more use of KRS Central Office services than did other KRS offices. Kansas Br. at 23, 26. Kansas asserts that it ceased allocating KRS Central Office costs to the area offices because a 1998 reorganization of SRS shifted

responsibility for supporting KRS area office staff away from the KRS Central Office and onto a new SRS division that oversees the area offices. Kansas argues that the Client Assistance Program received little support from the KRS Central Office because it was a client advocacy/ombudsman office that functioned independently of KRS.

Kansas also argues that its amended CAP effective for FY 2000 did not allocate KRS Central Office costs to the area offices or the Client Assistance Program because the CAP lists the offices that are allocated KRS Central Office costs, and the list does not include those offices. Kansas argues that its CAP for FYs 1998 and 1999 required neither allocation of KRS Central Office costs to the area offices or the Client Assistance Program nor allocation of costs pursuant to a time study. Kansas also asserts that it allocated costs based on all FTEs at the KRS offices, and argues that SSA improperly reallocated costs based only on the number of administrative or management FTEs at KDDS and other offices. Kansas also disputes SSA's determination of the number of administrative and management FTEs.

I. The cost principles required Kansas to allocate the costs of KRS Central Office services to benefitting activities according to the relative benefits received.

Kansas's overarching argument is that the cost principles, as applied by the Board and federal courts, permitted Kansas to allocate no KRS Central Office costs to the area offices and the Client Assistance Program because they received only minimal services, and permitted Kansas to allocate those costs instead to KDDS and other KRS offices that were the primary beneficiaries of the services. Kansas cites Oklahoma Dept. of Human Services, DAB No. 963 (1988) as holding that OMB A-87 does not require an allocation of costs to each benefitting program and that DCA may approve the assignment of costs exclusively to programs that primarily benefit from the cost. In Oklahoma, the Board held that the requirements of OMB A-87, as then in effect (including the proviso that a cost is allocable to a particular cost objective only to the extent of benefits received by such objective) "do not explicitly require any particular proportionate or pro rata allocation of joint costs, as long as the costs are allocated in an equitable manner to programs which actually benefit from the costs and the State follows the allocation methodology set out in the approved cost allocation

plan."[8] Id. at 4. The Board held that where a cost fully benefits more than one program, the federal agency has discretion to require either allocating it among the benefitting programs or assigning it exclusively to one of the fully benefitting programs.

The principles followed in Oklahoma do not apply here. In Oklahoma, the Board concluded that the entire amount of the joint costs at issue, costs for recruitment and approval of foster and adoptive homes, were fully assignable to each one of the two federal programs — title IV-B and title IV-E of the Social Security Act. In that circumstance, the Board concluded, the agency had discretion to approve allocating all of the costs to one of those programs. The Board's decision was based on the premise that the federal program to which the state had allocated the costs (title IV-E) required the state to incur all of the costs that it allocated to that federal program. The Board in Oklahoma also found that it was improper to allocate to title IV-E costs from which that program did not benefit at all. Oklahoma at 14-15. Kansas's argument that Oklahoma permits allocation to a federal program of costs that were neither incurred for nor benefit that program misinterprets that decision.[9]

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[8] OMB A-87 now states that "[a] cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received." Att. A, ¶ C.3.a. ASMB C-10, the implementation guide for OMB A-87, repeats this requirement and describes it as an underlying principle of cost allocation. ASMB C-10, ¶ 2.8.2; Question 2-11.

[9] Under ASMB C-10, if an awarding agency "determines that costs allocable to another program or cost objective are allowable under their program," then it may grant an exception to the requirement that costs benefitting multiple activities or programs be allocated in accordance with the relative benefits received by each activity or program, and "the unallocable costs may be bourne by their program." ASMB C-10, Question 2-12. This "shifting of unallocable costs" is permitted only when the head of the awarding agency advises the cognizant agency that under its enabling legislation, such cost shifting is allowed and expected. Id. "In the absence of such authorization, costs must be allocated to all benefiting programs." Id. This exception is consistent with the nature of the costs in Oklahoma, which were allowable under either federal program.

Here the issue is not whether the costs could be allocated to one of two federal programs, as in Oklahoma. Instead, the issue is whether costs that benefit state programs other than the one federal program to which they were allocated must be allocated to the state programs in accordance with the relative benefits. The costs that SSA disallowed were for administrative services provided in at least some degree to the area offices and the Client Assistance Program. Kansas does not deny that those offices received at least some KRS Central Office services or suggest that any of the services provided to those offices benefitted KDDS or related to the disability determinations that KDDS conducted on behalf of SSA. Furthermore, Kansas does not dispute SSA's assertion that KDDS had no staff in the area offices, and does not argue that the activities of the Client Assistance Program were eligible for SSA reimbursement. SSA Br. at 10, 11. Thus, services that the KRS Central Office provided to area offices and the Client Assistance Program that did not benefit KDDS were not allocable to KDDS.

Kansas also cites Arizona v. Thompson, 281 F.3d 248 (D.C. Cir. 2002) and Nebraska Dept. of Health and Human Services v. HHS, 340 F.Supp.2d 1 (D.D.C. 2004), rev'd and remanded, 435 F.3d 326 (D.C. Cir. 2006), as holding that OMB A-87 does not require an allocation of costs to all benefitting programs and as permitting allocation to a primary benefitting program, a practice that the courts referred to as "primary program allocation." 340 F.Supp.2d at 16; 281 F.3d at 251-52. Both decisions, however, addressed costs common to the administration of several programs that, as in Oklahoma, fully benefitted only the single federal program to which the state sought to allocate those costs, even though the other programs derived some benefit from them. Arizona, 281 F.3d at 251; Nebraska, 340 F.Supp.2d at 9-10, 13. In those cases, as the Arizona court noted, the state would have had to incur the costs for the primary program, even if the other programs did not exist. Moreover, Arizona involved TANF, and under the AFDC program which preceded TANF, the federal agency had a policy of permitting the states to allocate costs that were common to administration of the AFDC, Medicaid and Food Stamp programs fully to AFDC, a policy that ACF specifically set forth as an exception to the general rule of A-87. 281 F.3d at 251-52.[10] Kansas points to no such SSA policy here. Neither of

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[10] In Nebraska, which reversed the Board's decision in Nebraska Health and Human Services System, DAB No. 1882 (2003), the court of appeals held that the district court erred in approving Nebraska's title IV-E CAP after invalidating the policy

(continued...)

those decisions stands for the notion that a state may allocate to a federal program costs which do not benefit that program.

Kansas also argues that DCA consented to Kansas's use of primary program allocation during negotiations for the amended CAP which was effective for FY 2000, and that this consent constituted approval to allocate no costs to the excluded offices for FYs 1998 and 1999. However, as we discuss later, Kansas failed to demonstrate that it informed DCA that Kansas would not allocate costs to some benefitting offices or that DCA consented to the use of primary program allocation.

Accordingly, we conclude that the cost principles required Kansas to allocate costs of KRS Central Office services to the area offices and the Client Assistance Program in accordance with the relative benefits they received from the services. As we discuss next, the record shows that the area offices and the Client Assistance Program received administrative services from the KRS Central Office.

II. The area offices and the Client Assistance Program received administrative services from the KRS Central Office.

The bulk of the disallowance of KRS Central Office costs represents costs that SSA determined should have been allocated to the SRS area offices.[11] Kansas reports that it ceased allocating KRS Central Office costs to the area offices following a 1998 reorganization of SRS that gave the area offices greater administrative autonomy, after which they performed for themselves activities that had previously been performed by the KRS central office, including administrative services on behalf of KRS staff located in the area offices. The purpose of the reorganization, Kansas reports, was to consolidate client

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[10](...continued)
announcements (requiring proportional allocation) on which DCA's disapproval relied rather than remanding for the agency to determine whether the CAP would have been approved under the agency's prior policy.

[11] Although the audit report does not specify the amounts that SSA reallocated to the area offices and to the Client Assistance Program, respectively, the record indicates that SSA reallocated the costs based on the number of administrative or management FTEs in the offices that bore costs, and that SSA counted 11-16 FTEs at the area offices, and one FTE at the Client Assistance Program. Kansas Exs. 18, 19.

services in the area offices so that they could serve as "one stop" offices capable of identifying all of a client's needs and responding with appropriate services.[12] Kansas asserts that prior to the reorganization each SRS program area was run by an SRS Division (the Division of Children and Family Policy, the Division of Child Support Enforcement, the Division of Economic and Employment Support, the Division of Health Care Policy, or KRS), and that each division "had broad administrative responsibility for all aspects of the programs under its charge, including personnel-budget responsibility for each program's field staff working out of Area and local offices across the state." Kansas Ex. 1, ¶ 2 (declaration of the SRS director of rehabilitation services); see also Kansas Ex. 2, ¶ 2 (declaration of the former SRS director of accounting and administrative operations). The reorganization created a Division of Integrated Service Delivery (ISD) with its own director, to whom the directors of the area offices reported, as well as the directors of Child Support Enforcement (CSE), Economic and Employment Support (EES), and KRS. Kansas Ex. 1, ¶¶ 4-5.

As a result of the reorganization, Kansas asserts, the area office directors took on primary responsibility for staff budgeting for area office operations, a responsibility previously handled by the KRS, CSE and EES program heads, and for recommending personnel actions affecting area office staff. Id. After the reorganization, the area office directors "worked closely with the SRS Assistant Secretary for ISD and Program Directors in filling field staff positions." Id. The area offices provided office space and support services to field staff from KRS and other program agencies. Id., ¶ 2. Kansas asserts that following the reorganization the KRS Central Office had no budget responsibility for staff in the area offices and no responsibility for area office contracts or for area office

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[12] At the start of the audit period there were eleven area offices that served 105 Kansas counties and employed some 3,000 persons, although some offices have been consolidated and others closed since then. Kansas Ex. 2, ¶ 12; Kansas Ex. 10. In addition, there apparently were local field offices, although the parties did not indicate how many. It also is not clear whether the parties used "field offices" synonymously with "area offices," or whether this term referred to subdivisions of the eleven area offices that served smaller geographic areas. Kansas Ex. 1, ¶ 4. Despite closures and consolidations of area offices, the parties do not assert that there were any differences in the nature of the services that the KRS Central Office provided during the disallowance period.

management information systems. Id., ¶ 4. Kansas reports that "as a result of the 1998 reorganization, by comparison to the KRS component agencies to which KRS Central Office costs were allocated, the Area Offices drew relatively little on KRS Central Office resources." Kansas Ex. 2, ¶ 9.

SSA questions the purpose of the SRS reorganization and implies that it was primarily a means of shifting KRS Central Office costs to the SSA-funded KDDS, which was located in the central KRS office in Topeka and had no staff in SRS area offices. SSA describes the reorganization as creating only an artificial, paper distinction between the area offices and the KRS Central Office that resulted in KDDS remaining the same size for the purpose of allocating costs while the other KRS offices appeared to shrink. SSA Br. at 10, 11.

Regardless of the intent or effect of the reorganization of SRS, the record indicates that the area offices received at least some services from the KRS Central Office after the reorganization, and Kansas does not contend otherwise. Evidence that the area offices received KRS Central Office services includes the following:

- An audit workpaper states that the audit disclosed that "KRS provided policy review and oversight for KRS field offices." Kansas Ex. 6, at 7.

- A declaration of the former SRS director of accounting and administrative operations states that after the reorganization "the KRS Central Office would continue to provide program and policy guidance to the Area Offices while shifting day-to-day operational control of rehabilitation field staff and personnel and budget responsibilities to the Area Office directors." Kansas Ex. 39, ¶ 6.

- An e-mail to SSA from the KRS fiscal officer in April 2002 reports that "Area office employees and Local office employees . . . are provided primarily Rehabilitation Services program policy and guidance." SSA Ex. C.

- The audit report states that "KRS field offices received services from the KRS Central Office, including policy review and oversight." Kansas Ex. 14, at 6. The report further states that "[w]ith the exception of KS-DDS [KDDS], all KRS divisions, including the field offices, work together" to achieve KRS's mission of working with Kansas residents with disabilities to achieve their goals of

independence. Id. "KRS's mission is further indication that the KRS Central Office provides services to the divisions achieving its mission, including the KRS field offices." Id.

- The audit report states that the KRS Central Office must have been involved in area office activities because it reported those activities to the U.S. Department of Education (DOE) Rehabilitation Services Administration. Id.

Thus, the record demonstrates that KRS staff in the area offices continued to receive some administrative services from the KRS Central Office after the 1998 reorganization. Kansas does not dispute the above findings, but argues that these services were so minimal that their costs did not have to be allocated to the area offices. Kansas also argues that the KRS Central Office's role as conduit of DOE vocational rehabilitation policy to the area office staff, which Kansas characterizes as "provid[ing] policy guidance" to area office staff, was not sufficient to mandate an allocation of costs to the area offices. Kansas Ex. 1, ¶ 5.

The Board has suggested that the benefits that a program derives from a cost might be so insubstantial that, for reasons of administrative convenience, the state will not be required to allocate costs to that program. See, e.g., New York State Dept. of Social Services, DAB No. 1072, at 7-8 (1989); Oklahoma at 14-15. Kansas, however, did not quantify the amount of benefits received by the area offices and did not establish that the benefits were so insubstantial that Kansas would be justified in allocating no costs to those offices.

On the other hand, the record does not bear out SSA's assertion that the area offices received KRS Central Office services comparable to the services received by other KRS offices. SSA relies on the April 2002 e-mail from the KRS fiscal officer indicating that the KRS Central Office provided primarily KRS program policy and guidance to KRS staff working in the area offices. SSA Ex. C. That same e-mail also reports, however, that the KRS Central Office provided additional services to KRS agencies, including KDDS, that it did not provide to the area offices. Those other services comprised general management assistance; supervision of program administrator; budgeting and fiscal management and assistance; contract development, review and processing; position management review and processing; human resource management, review and oversight. Id. An audit

workpaper that SSA also cites states only that all KRS programs received “at least some benefit” from the Central Office

services; this statement does not necessarily contradict Kansas's assertion that the area offices experienced a reduction in their receipt of KRS Central Office services following SRS's reorganization. SSA Ex. D.

Nonetheless, the possibility that the reorganization might have resulted in some reduction of the services that KRS Central Office provided to the area offices did not necessarily entitle Kansas to reduce its allocation of costs to the area offices. Kansas was required to allocate costs consistent with its CAP, which allocated costs based on the number of FTEs in the benefitting offices. The CAP thus did not account for differences among offices in the amount of services they received per FTE. The CAP would not have permitted Kansas to reduce its relative allocation of KRS Central Office costs to the area offices if the number of KRS FTEs in the area offices did not decrease. The CAP moreover did not permit Kansas to exclude KRS FTEs on the basis that they were assigned to area offices. The CAP also would not have permitted Kansas to increase its allocation of costs to KDDS, absent an increase in the number of FTEs at KDDS, and/or an increase in the total amount of costs for KRS Central Office services.[13]

As to the KRS Client Assistance Program, Kansas asserts that it "plays an ombudsman role for rehabilitation clients, intervening and advocating with SRS on their behalf and mediating disputes with SRS." Kansas Ex. 1, ¶ 11. Kansas asserts that this was an unusual role for an SRS component agency, and that in most other states this function is contracted out to a quasi-public agency or a private entity such as a law firm. Id. Kansas argues that the Client Assistance Program functions independently of KRS and uses a negligible and limited amount of the Central Office services, consisting primarily of contracting for office space and providing telephone coverage during emergencies. Kansas Br. at 26. Kansas argues that the KRS Central Office exercises little day-to-day oversight of the Client Assistance Program and does not provide management consultation with respect to the

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[13] The record does not indicate whether Kansas's allocation of KRS Central Office costs to KDDS increased after the SRS reorganization in 1998. Although SSA determined that indirect costs claimed for KDDS as a percentage of KDDS's "total personnel services" increased from FY 2001 to FY 2002, the record also indicates that the amount of KRS Central Office costs that Kansas allocated to KDDS remained relatively constant during the disallowances period. Kansas Ex. 30, at 4; Kansas Ex. 37; Kansas Ex. 14, at C-1.

Client Assistance Program. Id. Kansas also asserts that the KRS Central Office kept "at arms-length" the two or three KRS FTEs who staffed the Client Assistance Program. Id. For that reason, Kansas asserts, the KRS Central Office "exercised very little budgetary discretion and did not provide management consultation with respect to the Client Assistance Program." Kansas Ex. 1, ¶ 11.

However, in contrast to the area offices, which the record indicates made less use of KRS Central Office services than some other KRS offices, the record indicates that the Client Assistance Program received KRS Central Office services akin to services received by other KRS offices. The e-mail to SSA from the KRS fiscal officer in April 2002 stated that there was no difference in what KRS provided to the Client Assistance Program and to other KRS agencies including KDDS. SSA Ex. C. Kansas does not dispute the contents of that e-mail or provide any basis for concluding that it was not a credible assessment of the services that the KRS Central Office provided to the Client Assistance Program. The cost principles do not permit Kansas to allocate any of the costs of those services to KDDS. Furthermore, the audit report states that according to Kansas, the Client Assistance Program "was excluded from the indirect cost allocation because its budget would not support indirect cost charges." Kansas Ex. 14, at 5. Kansas did not address that finding in its appeal. Kansas's submissions indicate that the Client Assistance Program receives federal funding, and the cost principles forbid shifting costs allocable to a particular federal award to another federal award "to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons." Kansas Ex. 1, ¶ 11, OMB A-87, Att. A, ¶ C.3.c. The budgetary limitations of the Client Assistance Program would not be a valid basis for Kansas to shift that program's costs to other programs such as KDDS.

III. Kansas's CAP for FYs 2000-2002 appears to contain a material defect and, if so, approval of that CAP does not preclude SSA from disallowing KRS Central Office costs that were not allocable to KDDS.

SSA determined that Kansas allocated to KDDS $2,751,072 in unallowable costs of KRS Central Office administrative services for FYs 2000-2002, primarily because Kansas failed to allocate

costs to the area offices and the Client Assistance Program, as required by the cost principles.[14] Kansas Ex. 14, at C-1.

Kansas asserts that its approved CAP for FYs 2000-2002 does not allocate KRS Central Office costs to the area offices or the Client Assistance Program. Kansas asserts that it amended the CAP effective FY 2000 to reflect the 1998 reorganization of SRS that Kansas says shifted responsibility for providing administrative services to KRS staff in area offices away from the KRS Central Office. The amended CAP contains a list of the offices that are allocated KRS Central Office costs, and the list does not include the area offices or the KRS Client Assistance Program. The parties agreed that for FYs 2000-2002, allocation was governed by the methodology set out in the description of Table D of the SRS CAP, "Distribution of Central Office Costs," as amended effective for FY 2000, and specifically by the description of Table D2 as amended, which states:

> **Table D2**
>
> Distributes central office costs for PCA 66110, Rehabilitation Services Administration - Central Office to PCAs 66310, CDC - Salina, 66410, CDC - Topeka, 66510, Deaf and Hard of Hearing Administration, 67110, Blind Services Administration and 68110, Disability Determination and Referral Services Administration, using headcount as a distribution method. Headcount is determined by using information taken from SHaRPs which indicates the number of FTE Staff Positions.

Kansas Ex. 7 (also submitted as part of SSA Ex. G).

In Table D2, "PCA," or Program Cost Account, represents an individual office or program whose costs are assigned to other programs or offices, or to which costs are assigned. "SHaRPs" is the Statewide Human Resource and Payroll System, the source of FTE headcount data.[15] Kansas Ex. 2, ¶ 6.

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[14] SSA also determined that for the entire disallowance period, Kansas allocated excessive costs to KDDS by allocating costs to KDDS based on the total number of FTEs, as compared with only the number of administrative or management FTEs at some other KRS offices. We address that determination later.

[15] KRS consisted of six components during the audit period: the KRS Central Office, the Blind Services Administration, the Commission for the Deaf and Hard of Hearing (CDHH), the Client

(continued...)

SSA does not dispute that the language of Kansas's approved CAP, as amended effective for FY 2000, does not allocate KRS Central Office costs to the area offices or the Client Assistance Program. SSA argues, however, that DCA's approval of the CAP amendment does not mandate approval of specific costs or preclude SSA from disallowing unallowable costs. SSA also argues that Kansas was not entitled to apply the amended CAP because when Kansas proposed the amendment it failed to inform DCA, the agency responsible for approving CAPs, that the area offices and the Client Assistance Program benefitted from KRS Central Office services.

Kansas argues that SSA is bound by the terms of the approved CAP amendment and may not disallow costs that Kansas claimed consistent with the CAP or retroactively reallocate costs in a manner that deviates from the methodology described in the CAP. Kansas denies that it provided inaccurate information about the CAP amendment, and asserts that DCA consented to Kansas using "primary program" allocation that allocated no costs to the area offices and the Client Assistance program.

A. Kansas has not shown that it informed DCA that the area offices and the Client Assistance Program benefitted from KRS Central Office services.

As evidence that Kansas failed to inform DCA that the area offices and the Client Assistance Program benefitted from KRS Central Office services, SSA submitted a declaration from the DCA senior negotiator who negotiated the CAPs that were in effect from FY 1998 onward. He states that when he negotiated the CAP amendment he believed that the excluded offices would not be receiving any benefit or support from the KRS Central Office because they were not included in the proposed amendment's list of KRS components that would receive an allocation of costs from

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[15](...continued)
Assistance Program, the Vocational Rehabilitation Centers (called Career Development Centers (CDC) and largely absorbed into the area offices before the end of audit period), and KDDS (the Disability Determination and Referral Services Administration in Table D2). Kansas Ex. 1, ¶ 5; Kansas Ex. 2, ¶ 6; Kansas Exs. 7, 18, 25; SSA Ex. I. Table D2 shows the PCAs assigned to these components, except the Client Assistance Program and staff from the component offices who worked in the SRS area offices. The KRS Central Office costs at issue are the "central office costs for PCA 66110, Rehabilitation Services Administration - Central Office." Kansas Ex. 2, ¶ 6.

the KRS Central Office. SSA Ex. J. SSA argues that Kansas thus violated requirements that a state provide accurate information in support of a proposed CAP and amend a CAP when it becomes aware of a material defect. 45 C.F.R. §§ 95.507(b)(8), 95.509(a)(2).

Kansas submitted two declarations from the former SRS director of accounting and administrative operations. He stated that in 1997 he and another Kansas official met with the DCA senior negotiator and that their discussions "included removal of Area Office staff from the KRS Central Office cost allocation base and increasing the proportion of KRS Central Office costs allocated to KDDS and the other KRS components." Kansas Ex. 2, ¶ 8. During the meeting, he stated, they specifically discussed "the fact that the KRS Central Office would continue to provide program and policy guidance to the Area Offices while shifting day-to-day operational control of rehabilitation field staff and personnel and budget responsibilities" to the area office directors. Kansas Ex. 39, ¶ 6. He stated that "DCA did not voice any concerns about or objections to the change," and that the DCA senior negotiator later stated that representatives of the federal programs agreed with the changes to the CAP, other than a proposal to include child support enforcement in a cost pool for field staff along with economic and employment support services. Kansas Ex. 2, ¶¶ 4, 8. Kansas argues that the senior negotiator's declaration is entitled to no weight as it conflicts with an audit worksheet stating that he did not "remember the change of details" pertaining to the exclusion of the area offices from the KRS Central Office cost allocation base, and was not familiar with whether the area offices benefited from the KRS Central Office expenses. Kansas Reply Br. at 9-10.

The Board need not resolve differences in the declarants' recollections for two reasons. First, even assuming that Kansas informed the DCA senior negotiator that the KRS Central Office would continue providing "program and policy guidance" to the area offices after the 1998 reorganization of SRS, Kansas has not alleged that it adequately apprised him of the full extent of the services that the KRS Central Office provided to the offices that Kansas excluded from allocation. Kansas has not established that it informed him of the specific services that were included within the general function of providing "program and policy guidance," or of whether it provided other services to the area offices. For example, Kansas reports that the area office directors "worked closely with the SRS Assistant Secretary for ISD and Program Directors [for KRS, CSE and EES] in filling staff positions," indicating that the Program Director for KRS (and thus the KRS Central Office) was involved in personnel matters

relating to KRS staff in area offices. Kansas Ex. 1, ¶ 4. Kansas also does not allege that it informed the DCA senior negotiator of the services that KRS Central Office furnished to the Client Assistance Program. As we noted above, those services may have been comparable in nature to the services that the KRS Central Office provided to KRS components that were allocated costs. (In this regard, we note that Kansas has not alleged that the reorganization of SRS had any effect on KRS's provision of administrative services to the Client Assistance Program. Yet, the approved CAP prior to its amendment in FY 2000 following reorganization treated that program like any of the other cost objectives.) Thus, Kansas has not established that, at the meeting with the DCA senior negotiator in 1997, it provided him enough information to make an informed decision about whether the amendment to Kansas's CAP effective for FY 2000 allocated KRS Central Service costs in accordance with the cost principles.

Second, Kansas has not documented that, in general, it accurately informed DCA, as required by the regulations, that the amended CAP did not allocate costs to KRS offices and programs that benefitted from them. Part 95 requires that a proposed CAP submitted by a state to DCA must describe the procedures used to identify, measure, and allocate all costs to each of the state's programs. Part 95 further requires that the CAP "[c]ontain sufficient information in such detail" to permit DCA, after consulting with the HHS Operating Divisions (or in this case SSA), to make an informed judgment on the correctness and fairness of the state's procedures for identifying, measuring, and allocating all costs to each of the programs operated by the state agency. 45 C.F.R. § 95.507(a)(1),(4). The CAP must provide a listing of all federal and all non-federal programs administered or serviced by the organizational units whose costs are charged to programs operated by the state agency, and a description of the activities performed by each state organizational unit. 45 C.F.R. § 95.507(b)(2),(3).

Kansas did not provide any evidence or documentation contemporaneous with its CAP amendment informing DCA that some of the KRS Central Office services were provided to area offices and the Client Assistance Program. Although Kansas's former SRS director of accounting and administrative operations referred to documentation shared with DCA in connection with the CAP, the only documentation he cited consisted of organizational charts showing which programs were under KRS, such as the Client Assistance Program. From these charts, DCA apparently was to have inferred that those offices received KRS Central Office services. Kansas Ex. 2, ¶ 10; Kansas Ex. 45. However, the organizational charts that Kansas submitted with its appeal file

do not identify or describe any of the services that the KRS Central Office provided to the various components listed on the charts, and Kansas has not identified that information in the record. Id. Kansas thus failed to comply with the regulation that required it to provide sufficient information in such detail as to permit DCA to make an informed judgment on the correctness and fairness of the state's procedures for identifying, measuring, and allocating all costs to each of the programs operated by the State agency.[16] 45 C.F.R. § 95.507(a)(1),(4).

DCA's approval of the amended CAP thus does not preclude a determination that the area offices and the Client Assistance Program must bear the cost of the services they received, that the CAP must be amended retroactively, and that SSA overpaid for KRS administrative services. As we discuss below, however, the initial determination that the information provided by Kansas was "materially incomplete or inaccurate" (so that the plan must be amended retroactively) is properly made by DCA, not SSA.

B. DCA's approval of the CAP amendment does not preclude SSA from disallowing unallowable costs.

Kansas argues that SSA may not retroactively reallocate or disallow costs that Kansas claimed pursuant to its approved CAP and may only require that Kansas amend its plan prospectively. Kansas cites New York State Office of Children and Family Services, DAB No. 1831 (2002), where the Board observed that an approved CAP generally continues in effect indefinitely if the state submits an annual statement to DCA certifying that the CAP is not outdated, and Oklahoma, where the Board stated that approval of a CAP by DCA "gives rise to a presumption that the approved allocation methods are valid." Oklahoma at 6-7 (1988)

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[16] We do not agree with Kansas that the audit worksheet reporting statements of the DCA senior negotiator conflicts with his declaration that he believed, when he negotiated the CAP amendment, that the excluded offices would not be receiving any benefit or support from the KRS Central Office. Kansas Ex. 47. The workpaper states that he did not remember "the change of details of this event" and "was not familiar/had expertise in" Table D2 of the CAP. Id. The worksheet indicates that he was not discussing the negotiation of the CAP amendment or whether the area offices and the Client Assistance Program used KRS Central Office services following the 1998 SRS reorganization. Under discussion instead was how the area offices were allocated costs under the earlier version of the CAP prior to the 1998 reorganization. Id.

(emphasis in decision). Kansas also notes that the portion of OMB A-87 applicable to indirect costs incurred by state entities other than public assistance agencies provides that once an allocation agreement with the governmental unit has been reached, the agreement will be accepted and used by all Federal agencies. Att. C, ¶ F.1.

However, in New York the Board additionally held that "[a]n approved CAP is not an unalterable 'contract' binding the parties, and approval of a CAP cannot make a cost allowable (or allocable) contrary to statute or regulation." DAB No. 1831, at 2, citing Oklahoma and other decisions.[17] Part 95 moreover requires a state to "promptly amend the cost allocation plan and submit the amended plan to the Director, DCA if . . . [a] material defect is discovered in the cost allocation plan by the Director, DCA or the State." 45 C.F.R. § 95.509(a). DCA could thus require Kansas to amend its CAP if DCA were to conclude that the CAP contains a material defect in allocating no KRS Central Office costs to some benefitting cost objectives. However, the record contains no indication that DCA has determined whether Kansas's amended CAP contains a material defect requiring its modification. That question is within DCA's purview, as the regulations vest DCA with responsibility for the negotiation and approval of states' CAPs. 45 C.F.R. § 95.503. DCA review of these issues is important because retroactive change to a cost allocation methodology may affect more than one program and because an allocation methodology that may seem inequitable when taken out of context may be reasonable when considered in the context of the CAP as a whole.

If DCA were to determine that the CAP as amended effective for FY 2000 contains a material defect, it could require that Kansas amend its CAP, retroactive to the effective date of the original amendment. 45 C.F.R. § 95.515. Accordingly, we remand the disallowance of KRS Central Office costs for FYs 2000-2002 for SSA to obtain DCA's determination as to whether Kansas's amended CAP, as effective for FY 2000, contains a material defect requiring its modification, and, if so, to afford Kansas an opportunity to propose a new CAP amendment that would be effective as of FY 2000 and that would allocate KRS Central Office costs to the various benefitting offices or PCAs in accordance with the requirements of the applicable cost

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[17] SSA does not contend that the types of administrative services at issue here, if properly allocable to KDDS, would not be allowable charges to SSA funds.

principles.[18] In its proposal, Kansas should address issues that we discuss later in this decision concerning the method for counting FTEs and the extent to which KDDS benefitted from KRS Central Office services and SSA should consult with DCA concerning these issues to the extent necessary to allocate KRS Central Office costs consistent with Kansas's CAP and the cost principles. Throughout the remand process, Kansas, as the recipient of federal funds, bears the burden of documenting that its costs were allocable.

Once DCA has made its determinations, SSA may issue a revised disallowance that reflects the terms of either the existing CAP or the new CAP. If SSA issues a revised disallowance, Kansas may appeal it to the Board within 30 days after receiving it.

IV. Kansas's CAP for FYs 1998-1999 did not permit Kansas to exclude the area offices and the Client Assistance Program from being allocated KRS Central Office costs. The parties' dispute over which part of the CAP applied is moot.

SSA determined that Kansas allocated to KDDS $1,551,246 in unallowable costs of KRS Central Office administrative services for FYs 1998 and 1999, primarily because Kansas failed to allocate costs to the area offices and the Client Assistance Program.[19] Kansas Ex. 14, at C-1. The parties agree that the CAP in effect for those years, prior to its amendment effective for FY 2000, did not identify individual offices that were allocated costs. SSA argues that the cost principles required Kansas to allocate costs to those offices because they received KRS Central Office services. SSA also argues that the CAP

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[18] Kansas may appeal to the Board a final written determination from DCA that the CAP contains a material defect, or disapproving a CAP that Kansas proposes to replace its CAP effective as of FY 2000. Under 45 C.F.R. Part 16, the Board reviews final written decisions related to CAPs negotiated with state governments; this includes decisions as to whether a CAP contains a material defect that would require its amendment. 45 C.F.R. Part 16, App. A, ¶ D; see New Jersey Dept. of Human Services, DAB No. 1801 (2001).

[19] As with the disallowance of KRS Central Office costs for FYs 2000-2002, SSA also determined that for the entire disallowance period, Kansas allocated excessive costs to KDDS because allocated costs to KDDS were based on the total number of FTEs whereas costs allocated to some other KRS offices were based only on the number of administrative or management FTEs.

required that Kansas allocate the costs pursuant to a time study, and that Kansas violated this requirement because it did not conduct a time study. A time study or random moment time study generally entails observing or recording the activities that workers are engaged in at randomly selected moments. See, e.g., Missouri Dept. of Social Services, DAB No. 1899 (2003); New Jersey Dept. of Human Services, DAB No. 1761 (2001); Washington State Dept. of Social and Health Services, DAB No. 924 (1987).

Kansas argues that the CAP did not require that costs be allocated to the area offices and the Client Assistance Program because the CAP did not specify which offices or PCAs would be allocated costs and did not specify "whether the allocation would be on a primary or all-benefiting program basis." Kansas Reply Br. at 5-6. Kansas argues that DCA consented to Kansas using primary program allocation in Kansas's amended CAP effective for FY 2000, and that this consent also meant that DCA read the CAP in effect during FYs 1998 and 1999 as permitting Kansas to allocate no costs to the excluded offices during those years. Kansas also asserts that the CAP allocated these costs not pursuant to a time study but based on the number of FTEs in benefitting offices, and that SSA relies on an inapplicable provision in the CAP.

As discussed earlier, the cost principles do not permit Kansas to allocate costs only to primary benefitting programs, where not all of the costs benefit those programs, and the Board and court decisions that Kansas cites as permitting primary program allocation are not applicable. Thus, whether or not the CAP specifically identified cost centers for the area offices and the Client Assistance Program as benefitting cost objectives, the CAP should be interpreted to require Kansas to allocate to those cost objectives the costs of services that the KRS Central Office provided to the area offices and the Client Assistance Program. Moreover, Kansas reports that it ceased allocating KRS Central Office costs following the 1998 reorganization of SRS and that during the CAP negotiations it proposed to DCA to no longer include area office FTEs in the allocation base for KRS Central Office costs. Kansas Ex. 2, ¶¶ 4, 8; Kansas Ex. 39, ¶ 6. This indicates that Kansas had interpreted the CAP in effect in FY 1998 and 1999 to provide for allocating costs to area offices based on their numbers of KRS FTEs.

The parties agree that the methodology in the description of "Table D" of Kansas's CAP for FYs 1998 and 1999 governed the allocation of KRS Central Office costs but dispute which provision of Table D governed the allocation of the costs to

various KRS offices including KDDS. For those years, Table D provided as follows:

Table D - Distribution of Central Office Costs.

Table D1
Distributes central office costs for VR and MHDD [PCA 61110] using headcount as a distribution method. Headcount is determined by using information taken from SHaRPs which indicates the number of FTE staff positions.

Table D2
Data from the R.E.S.T. time study is used to determine the percentage of [PCA 66110] costs to be allocated to each VR reimbursement category.

Table D3
Distributes Administrative Hearings [PCA 33030] costs using a 100% time study.

Kansas Ex. 8 (also submitted as part of SSA Ex. G) (brackets in original).

As used in Table D, "VR," or vocational rehabilitation, means KRS (Kansas Rehabilitation Services); central office costs for VR, or PCA 66110, are the KRS Central Office costs at issue here. Kansas Ex. 1, ¶ 5; Kansas Ex. 2, ¶ 6; Kansas Ex. 6, at 7; Kansas Ex. 20; SSA Ex. D. "R.E.S.T" is Random Employee Sampling Technique, a random-moment time study. SSA Ex. A, ¶ 3.

SSA asserts that Table D2 governed the allocation of KRS Central Office costs to the various KRS offices that benefitted from Central Office services and required Kansas to use data from the R.E.S.T. time study to allocate KRS Central Offices costs. SSA submitted a declaration by the director of the SSA OIG regional audit division stating that the CAP for FYs 1998 and 1999 required allocation of KRS Central Office costs "based on a Random Employee Sampling Technique (R.E.S.T.) time study." SSA Ex. A, ¶ 3. SSA also cites cost allocation worksheets that Kansas submitted with its brief that show, as Kansas acknowledged, the allocation of KRS Central Office costs in columns labeled "Table D2." Kansas Ex. 18; Kansas Ex. 39, ¶ 4. SSA cites the worksheets as evidence that Kansas viewed Table D2 as controlling the allocation of KRS Central Office costs. Had Kansas provided the results of a time study, the declaration states, "statistics regarding the percentage of time . . . [KRS] Central Office staff spent providing support to KDDS in

comparison to other entities under its purview would have been available to OIG." SSA Ex. A, ¶ 3.

Kansas argues that Table D1 applied and allocated costs to benefitting offices on the basis of the number of FTEs in each office. The former SRS director of accounting and administrative operations stated in a declaration that Table D2, which called for a time study, "governed how KRS Central Office costs were to be allocated between vocational rehabilitation programs once they had been allocated to the Area Offices on the basis of their number of rehabilitation FTEs." Kansas Ex. 39, ¶ 4. During the audit, Kansas similarly informed SSA that the time study was used to allocate costs for area office employees that have multiple job duties. Kansas Ex. 20. The former SRS director of accounting and administrative operations stated that this methodology was used prior to the reorganization, when the KRS Central Office had responsibility for KRS staff in area offices, and Kansas allocated KRS Central Office costs to the area offices. Kansas Ex. 39, ¶ 4. He explained that the cost allocation worksheets that SSA cited show the allocation of KRS Central Office costs in columns labeled "D2" to distinguish those costs from Mental Health Administration (MHDD) costs, which were shown in columns labeled "D1." Id.; Kansas Ex. 18.

The weight of the evidence supports the use of FTEs to allocate KRS Central Office costs to component offices such as KDDS. Table D1 "[d]istributes central office costs . . . using headcount as a distribution method," and Table D2 then states that time study data are used to determine the percentage of costs to be allocated to "each VR reimbursement category." Read together, the two tables are consistent with a system that allocates administrative costs to different component offices on the basis of their relative size (their number of FTEs) and then uses time study data to further allocate those costs among the various programs that the offices administer. Allocating KRS Central Office costs among component offices based on FTEs is appropriate because the extent to which those offices use KRS administrative services is logically related to their relative size. A time study is appropriate for determining the amount of time that employees who work on multiple programs devote to each program that receives an allocation of administrative costs. This is consistent with Kansas's declaration testimony that the time study was used to allocate administrative costs associated with area office staff among the multiple programs that they work on. Conversely, no time study data would be needed to allocate costs assigned to KDDS, since its employees work exclusively on one program. This reading of the CAP is also consistent with Table B of the CAP, "Area Office Headcount," which states that

the distribution of area office administrative costs to field staff is based upon field staff headcount (determined from SHaRPs FTE data), and that time study data are used to determine the percentage of costs to be allocated to each reimbursement category. Kansas Ex. 9 (also submitted as part of SSA Ex. F).

A finding that the CAP allocated costs to component offices based on FTEs is also consistent with opinions of SSA auditors and the DCA senior negotiator recorded in audit materials in the record. An audit workpaper states that Kansas's method of allocating Central Office costs based upon FTE staff position "is in compliance with the approved plan for FY 1998 through current." Kansas Ex. 6, at 7. It further states that the DCA senior negotiator, after discussing the issue, agreed that the CAP allowed Kansas to allocate KRS Central Office expenses for these years based on FTEs, and that SSA OIG agreed with the DCA senior negotiator. Id., at 7-8; see also Kansas Ex. 25 (workpaper citing the language from Table D1 as applicable for FYs 1998 and 1999). An appendix to the audit report states that "KRS Central Office costs are allocated based on Full-Time Equivalents (FTE)." Kansas Ex. 14, at C-1. Since the audit report states that the auditors examined the CAPs for FYs 1998 through 2002, that statement could have been referring to the CAP for FYs 1998 and 1999 that SSA now reads instead as requiring the use of a time study. Id. at 3.

SSA does not address the audit workpapers or the reported statement of the DCA senior negotiator. Indeed, SSA did not assert that the CAP required a time study prior to SSA's brief before the Board, some two years after SSA took the disallowance. The declaration of the director of the SSA OIG regional audit division stating that the CAP for FYs 1998 and 1999 required a time study, which was prepared shortly before SSA submitted its brief, offers no analysis or explanation of his conclusion, and does not explain why the reported statement of the DCA senior negotiator was not correct. SSA did not address the content of Table D1, which distributes Central Office costs using headcount as a distribution method. SSA's position that costs were distributed based solely on a time study would render Table D1 superfluous, whereas a finding that the CAP allocated costs to component offices using FTEs and then further to programs based on time study data gives meaning to all parts of the CAP.

Moreover, the issue is effectively moot, because there is no evidence that Kansas ever conducted the type of time study that SSA argues was required to allocate KRS Central Office costs to component offices, and because SSA calculated the disallowance by reallocating costs based on the number of FTEs, thus accepting

for that purpose Kansas's interpretation of its CAP. Because that interpretation is consistent with the CAP language, we apply it as well.

In the next section of the decision, we consider the parties' dispute over the method for counting FTEs in the offices to which SSA reallocated KRS Central Office costs.

V. Allocation of KRS Central Office costs based on only management or administrative FTEs is not consistent with the requirements of the CAP, and the record is not dispositive on whether Kansas allocated costs to some offices on that basis.

SSA reallocated KRS Central Office costs for the entire disallowance period based on FTEs but employed a different methodology of counting FTEs than Kansas says was required by its CAP. The audit determined that Kansas counted all FTEs at KDDS but only administrative or management FTEs at the other KRS offices, resulting in KDDS being allocated disproportionate costs compared to those other offices.[20] Kansas Ex. 14, at 6, n.7. SSA reallocated costs based on what SSA determined was the number of administrative or management FTEs at the offices that were allocated costs, including KDDS, as well as at the area offices and the Client Assistance Program. Id. Whereas Kansas had allocated costs to anywhere from 143 to 255 total KRS FTEs depending on the quarter, of which 104 to 129 were from KDDS, SSA reallocated costs to only 29 to 35 FTEs, of which 11 to 16 FTEs were from the area offices, one was from the Client Assistance Program, and four to five were from KDDS.[21] Kansas Exs. 19; 25,

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[20] SSA asserts that Kansas allocated KRS Central Office costs to only administrative or management employees in the following PCAs: CDC-Salina, CDC-Topeka, Deaf and Hard of Hearing Administration, and Blind Services Administration. SSA Br. at 29, citing SSA Ex. A, ¶¶ 4, 5. Those PCAs, along with KDDS, are all the PCAs to which the CAP as amended for FY 2000 allocates KRS Central Office costs. Kansas Ex. 7. The CAP for FYs 1998 and 1999 did not specify which PCAs would be allocated KRS Central Office costs. Kansas Ex. 8.

[21] SSA determined that Kansas's allocation of KRS Central Office costs failed to account for anywhere from 150 to 223 KRS employees or FTEs, at least through FY 2000. SSA Ex. A, ¶ 4; Kansas Ex. 25, at 2. It is not clear whether all of the excluded employees or FTEs were from the area offices and the Client

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at 2. SSA asserts that its reallocation method was determined at meetings with Kansas SRS staff during and after the audit. SSA Ex. A, ¶¶ 5, 6; SSA Ex. J, ¶ 6.

Audit workpapers reveal that SSA reallocated costs based on administrative or management FTEs because the auditors determined that this is what Kansas had done for offices other than KDDS, and because the auditors considered this to be an equitable method. The workpapers indicate that the auditors based their determination of how Kansas had allocated costs on their understanding that the PCAs for at least some of the KRS offices other than KDDS consisted of only administrative office personnel. One audit workpaper states that while the FTE numbers represented the entire staff associated with the PCA code for the offices that were allocated costs, some PCA codes "related to administrative office personnel only, like the Commission of Deaf and Hard of Hearing Administration, Blind Services Administration, and Rehabilitation Center for the Blind-Administration." Kansas Ex. 23 (also submitted as part of SSA Ex. I). Another audit workpaper reflects the auditors' determination that because one of those PCAs included the word "administration" in its name, the PCA for KDDS should likewise include only administrative or management employees because it was named the "Disability Determination and Referral Services Administration." Kansas Ex. 43 (also submitted as part of SSA Ex. I); see also Kansas Ex. 7 (CAP as amended for FY 2000).[22]

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[21](...continued)
Assistance Program, or whether some were not from those offices and were excluded because they were not administrative or management FTEs. Id.

[22] The workpaper states that "the CAP wording of the PCA 67110 [Blind Services Administration] and the DDS [KDDS], 68110, did not differ - both used the word 'administration' and therefore if the FTE number being used for PCA 67110 is 4 then to be consistent management only numbers of the DDS should be used also." Kansas Ex. 43. The workpaper states Kansas staff reported having used an incorrect number of FTEs for the Blind Services Administration PCA to allocate costs, and that the correct number was four to five FTEs depending on the quarter (instead, apparently, of the 64 or 70 FTEs listed for that PCA on other audit worksheets). Id.; Kansas Exs. 23, 26. Kansas told the auditors that the original number was "linked to the wrong cell in error." The record does not establish that the higher number of Blind Services Administration FTEs that Kansas
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One of those audit workpapers states that a discussion among the auditors, the KRS fiscal officer and the DCA senior negotiator determined that it was equitable to reallocate costs "using management FTEs" because the KRS Central Office "provided management support/services to the benefiting agencies . . . ." Kansas Ex. 23; see also SSA Ex. C. Another audit workpaper states that the DCA senior negotiator thought that Kansas's allocation method charged an inequitable share of KRS Central Office costs to KDDS and agreed that a more equitable allocation method would be to utilize management FTEs for all benefitting components since the KRS Central Office was an oversight office, and provided oversight activities. Kansas Ex. 6, at 8. The DCA senior negotiator stated in his declaration that he believed that the decision to count only administrative or management FTEs was "reasonable, equitable and in compliance with" OMB A-87. SSA Ex. J, ¶ 6. SSA decided to "include only management FTEs of the components that received benefits from the KRS Central Office. . . . since the KRS Central Office provide management [oversight] and assistance to management personnel." Kansas Ex. 6, at 8-9.

Kansas denies that it allocated costs only to administrative or management FTEs at any offices and asserts that its CAP requires allocation to all FTEs. The former SRS director of accounting and administrative operations stated in a declaration that Kansas's practice was to allocate costs on the basis of all FTEs, and that during the audit period "some KRS components may have had only what the auditors considered administrative-type personnel while others had both administrative and non-administrative personnel." Kansas Ex. 2, ¶ 11. He and the director of KDDS stated that Kansas allocated costs using FTE information from SHaRPs, and that SHaRPs reports indicate the number of FTE positions and do not distinguish between administrative or management FTEs and other FTEs. Id.; Kansas Ex. 3, ¶ 5. While he noted that SHaRPs reports sometimes contained erroneous or incomplete FTE headcount data, he asserted that Kansas staff were instructed to use corrected data when information on SHaRPs reports looked incorrect in light of what they knew about the staffing of SRS components. Kansas Ex. 2, ¶ 6.

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[22](...continued)
erroneously used to allocate costs was the actual total of FTEs for that agency, or how SSA determined that the lower number was the number of administrative or management FTEs.

Kansas also denies that it consented to SSA's reallocation of costs based on administrative or management FTEs. Kansas submitted a declaration from the former SRS director of accounting stating that he "can state with certainty that SRS representatives did not agree that such a reallocation (or any reallocation) was proper," and that SRS staff would not have been authorized, during meetings relating only to the SSA audit, to consent to a reallocation methodology that could have impacted how Kansas allocated central office costs of other SRS divisions. Kansas Ex. 39, ¶ 3. Kansas also disputes SSA's determination that there were only four or five administrative or management FTEs at KDDS, and asserts that during the disallowance period KDDS had approximately 20 FTEs classified as administrative personnel and 10 FTEs classified as supervisors. Kansas Br. at 32, citing Kansas Ex. 5. Kansas asserts that if SSA had reallocated costs among all FTEs, including (KRS) FTEs from the area offices, KDDS would have been allocated between 29% and 31% of KRS Central Office costs for FYs 1998 - 2000 and similar percentages for FYs 2001 and 2002, instead of the 12.9% to 14.29% of costs that SSA allocated to KDDS. Kansas Reply Br. at 2, citing Kansas Exs. 18, 25.

The record does not establish whether Kansas allocated costs to KRS offices other than KDDS based on only administrative or management FTEs.[23] Kansas submitted evidence showing that, at

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[23] Although SSA in its briefs does not explain how it determined the number of administrative or management FTEs that it used in the reallocation, audit materials and SSA emails in the record indicate that the auditors made their determinations based on a "KRS directory" (or "Rehabilitation Service Directory") and from "VR organizational charts on DDS." Kansas Exs. 16, 19, 27. A declaration of the director of the SSA OIG regional audit division also states that SSA formulated the "modified headcount" during discussions with representatives from Kansas and DCA. SSA Ex. A, ¶ 5. As noted above, Kansas denies that it consented to SSA's reallocation methodology. An audit workpaper concerning the number of management and administrative CDC staff at two area offices indicates that one of the area offices had 14 FTEs on its organizational chart and four FTEs listed as "Public Service Executive (PSE)" or "Office Assistants (OA)," and that the other had 21 FTEs and five listed as PSE or OA, and that the auditors therefore determined that four FTEs should be used at each of the 11 area offices, to account for CDC. Kansas Ex. 28. However, cost reallocation worksheets that Kansas submitted indicate that SSA counted a total of 11-16 FTEs

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least, it was not its intent to allocate costs in that manner. And although SSA asserts that it reallocated costs using Kansas's administrative and management FTE head counts, cost reallocation worksheets that Kansas submitted indicate that SSA used lower headcounts than Kansas used for some of the KRS agencies for which SSA determined that Kansas had counted only administrative or management FTEs. SSA Br. at 26; SSA Ex. A, ¶ 5; Kansas Exs. 18, 19, 25.

The record also does not establish why it would be more equitable to allocate KRS Central Office costs to only management or administrative FTEs, as the auditors and the DCA senior negotiator apparently concluded. KRS Central Office services included, among other things, contract development, review and processing; position management review and processing; and human resource management, review and oversight. SSA Ex. C; Kansas Ex. 14, at 5. It is not clear why the extent to which a KRS component utilized those services would not have been related to the total number of office staff, including non-administrative personnel. Before the Board, SSA does not argue that allocation based only on administrative or management FTEs was more equitable than allocation based on all FTEs, and states that the auditors, in reallocating costs, could have counted all FTEs. SSA Br. at 29-30. And, the DCA senior negotiator's statement that counting only administrative or management FTEs was reasonable, equitable and in compliance with OMB A-87 is conclusory; he nowhere denies that the CAP language used all FTEs and does not assert that the reallocation is consistent with the CAP.

However, the issue we must address is what allocation method was required by Kansas's CAP. As we discussed earlier, the evidence indicates that the methodology in Table D1 of the CAP for FYs 1998 and 1999 allocated KRS Central Office costs to component offices based on FTE headcount. The CAP stated that "headcount" was determined by using SHaRPs information on the number of FTE staff positions, made no reference to management or administrative FTEs, and thus did not permit allocation to component offices on the basis of their management or administrative FTEs only. SSA does not dispute Kansas's declarations stating that the SHaRPs reports indicate the number of FTE positions and do not distinguish between administrative or management FTEs and other FTEs. Kansas Ex. 2, ¶ 11; Kansas Ex. 3, ¶ 5. The CAP language thus supports the use of a full FTE

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[23](...continued)
from the area offices in its reallocation. Kansas Ex. 19.

headcount. As we have discussed, costs must be allocated and claimed pursuant to the terms of a state's approved CAP. SSA in reallocating KRS Central Offices costs should thus have included all FTEs in the allocation base. Even if the auditors considered allocation based on administrative or management FTEs to be more equitable than allocation based on all FTEs, SSA in its reallocation was not free to ignore the language of the CAP.

For FYs 2000-2002, the amended CAP allocates costs based on FTE headcount data from SHaRPs and does not limit allocation to only administrative or management FTEs. Unlike the earlier CAP, the amended CAP allocates costs to identified PCAs. As noted above, an audit workpaper states that the PCA codes for some offices related only to their administrative office personnel. SSA Kansas Ex. 23; see also Kansas Ex. 2, ¶ 6; Kansas Ex. 7 (PCA codes). That the cost centers labeled "administrative" may not, like the account for KDDS, include all staff of the related KRS component is irrelevant, however. Some cost centers may be used merely to accumulate joint costs for distribution to the ultimate cost objectives (for example, different programs operated by the component). Use of such cost centers is, however, irrelevant to the question of what distribution base should be used to allocate costs to that cost center.

DCA's approval of allocation to the specified PCAs means that they were considered appropriate groupings of costs. See OMB A-87, Att. D, ¶ E.1. The mere fact that one cost center to which administrative services costs are allocated might group costs of all employees of a particular component, whereas another may not, does not necessarily violate the consistency principle. One cost center could include all administrative and direct services costs if the component runs only one program (such as KDDS), whereas another component may have more than one final cost objective (e.g., project or program), making it necessary to accumulate all costs of administrative and management services into a cost center which will then be further allocated among the final cost objectives. Even if only the salaries of administrative and management personnel for a specific component are accumulated in a cost center, all of the FTEs for the component should be included in the distribution base used to determine the relative benefits KRS components received from KRS Central Office activities.

We thus conclude that allocation to all FTEs is more consistent with the CAP than allocating costs based on only administrative or management FTEs. Accordingly, as part of the remand of the disallowance of KRS Central Office costs, SSA should consult with DCA to determine the number of FTEs from the various KRS

components, including KRS staff in the area offices and the Client Assistance Program, to be included in the allocation base consistent with the requirements of the CAP.

After SSA's consultation with DCA has been completed, SSA may then re-compute the disallowance consistent with DCA's recommendation and the applicable legal principles. SSA should use those FTE figures in re-computing the disallowance. DCA may well determine that any amended allocation methodology that DCA approves effective as of FY 2000 should also appropriately be applied for the earlier period. If Kansas disagrees with SSA's re-computation of the disallowance for the earlier period based on DCA's recommendation, it may appeal to the Board within 30 days of receiving notice of SSA's determination. Throughout SSA's consultation with DCA, SSA should provide an opportunity for Kansas to present its position and supporting evidence. Kansas may appeal to the Board SSA's final written decision disallowing any of its claims within 30 days after receiving it. As we stated above, throughout the remand process, Kansas, as the recipient of federal funds, bears the burden of documenting that its costs were allocable.

Disallowance of SRS Administrative Division costs allocated to KDDS

SSA disallowed $621,288 that Kansas claimed for the costs of administrative services provided to KDDS by the SRS Administrative Division. SSA disallowed the costs on the ground that Kansas failed to allocate costs to five State medical institutions that benefitted from the services. The five State medical institutions are the Kansas Neurological Institute, Larned State Hospital, Osawatomie State Hospital, Parsons State Hospital, and Rainbow Mental Health Facility. Kansas Br. at 21; Kansas Ex. 14, at 7. The audit found that the services "include those related to executive services, human resources, and budgeting," that the SRS Administrative Division executive staff makes decisions regarding the medical institutions' operations such as capital improvements, staffing, and salary levels, and that "the human resources staff also provides services to the State medical institutions to include staffing-related assistance." Kansas Ex. 14, at 7. SSA determined that Kansas's failure to allocate SRS Administration Division costs to the State medical institutions did not result in an equitable allocation of costs to all benefitting activities and failed to treat the costs of SSA disability programs consistently with respect to the costs of other benefitting component agencies within SRS, as required by OMB A-87. The Circular requires that costs be accorded consistent treatment and that indirect cost

pools be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived. Att. A, ¶¶ C.1.f; F.1.

The CAP provision that the parties agree governed the allocation of these costs for the entire disallowance period, "Table A," refers to them as "Departmental (Central Office) Indirects."[24] Kansas Ex. 10; SSA Ex. F; Kansas Br. at 21; DCA Br. at 18. "Worksheet I" of the CAP describes the costs as "[a]dministrative expenditures of the [SRS] Central Office which cannot be directly attributed to one specific program, providing general administrative functions for the entire agency." SSA Ex. F. The CAP "[a]llocates central office indirects to area office administration, area office field staff, and to the remaining PCA's [Program Cost accounts] which are administrative in nature." Id.; Kansas Ex. 9. The CAP then describes different methods for distributing costs. The audit determined that the CAP allocated the costs at issue here among SRS activities based on the number of FTEs. Kansas Ex. 14, at 7.

Parties' arguments

SSA argues that the CAP requires that SRS Administrative Division costs be allocated to State medical institutions because the costs were, in the language of the CAP, "administrative expenditures of the [SRS] Central Office which cannot be directly attributed to one specific program, providing general administrative functions for the entire agency," and the institutions were components of "the entire agency." Kansas Ex. 6, at 2-3. SSA determined that Kansas allocated SRS Administrative Division costs using a total of 4,022 FTEs from various SRS agencies but excluded from the distribution base 2,499 FTEs assigned to the five State medical institutions. SSA thus reallocated the costs among all 6,521 SRS FTEs, including those from the State medical institutions, and disallowed the amount that Kansas allocated to KDDS that was attributable to the State medical institutions. Id.; Kansas Ex. 14, at 7.

Kansas argues that the CAP does not require allocation of SRS Administrative Division costs to the State medical institutions because it allocated costs only to "PCA's which are

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[24] While the CAP refers to these costs as "Departmental (Central Office) Indirects," the parties refer to them as SRS Administrative Division costs, as do we, to avoid confusion with the KRS Central Office costs discussed in the preceding portion of this decision.

administrative in nature," whereas the State medical institutions employ predominately direct care staff and are not administrative in nature. Kansas asserts that DCA was aware when it approved the CAP that the State medical institutions benefitted from SRS administrative services from an organizational chart provided with the proposed CAP and from CAP language describing SRS as providing "general administrative functions for the entire agency." Kansas Ex. 45; SSA Ex. F. Kansas argues that DCA also was aware that the State medical institutions, which received SRS Administrative Division services, would not be allocated costs because they were not administrative in nature. Kansas argues that SSA was required to consult with DCA during the CAP approval and that because SSA did not object to the proposed methodology, it consented to Kansas allocating no costs to the State medical institutions.[25]

Kansas also argues that the State medical institutions were allocated SRS Administration Division costs indirectly, through the Mental Health and Developmental Disabilities Administration (MHDD), which oversees the medical institutions.[26] The former SRS director of accounting and administrative operations stated that in accordance with Table A of the CAP, Kansas allocated SRS Administrative Division costs to SRS components that are administrative in nature, including KRS, KDDS and the Mental Health and Developmental Disabilities Administration (MHDD).

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[25] Kansas cites a requirement that where a federal funding agency has reason to believe that special operating factors affecting its awards necessitate special consideration, the funding agency will, prior to the time the plans are negotiated, notify the cognizant agency, and a requirement that DCA, in reviewing a proposed CAP or CAP amendment, consult with the affected operating divisions. OMB A-87, Att. C, ¶ F.1; 45 C.F.R. § 95.111(a).

[26] A declaration of the former SRS director of accounting and administrative operations states that the SRS Mental Health Administration and the SRS Developmental Disabilities Administration are the SRS components that run the State's medical institutions for the mentally ill and developmentally disabled. Kansas Ex. 2, ¶ 2. SSA organizational charts show the five State medical institutions as part of an organization named "Mental Health/Dev Dis" and "Substance Abuse, Mental Health/Dev Dis" in 1998 and 1999, and "Health Care Policy" 2000 and 2001, a change that resulted from the 1998 reorganization of SRS, which created a Division of Health Care Policy within SRS. Kansas Ex. 45; Kansas Ex. 2, ¶¶ 2, 3.

Kansas Ex. 2, ¶ 14. It then further allocated MHDD costs to the State medical institutions on the basis of SHaRPS data, in accordance with Table D1 of the approved CAPs.[27] Id. Kansas also asserted, in comments to the draft audit report but not in its brief, that the State medical institutions were charged for SRS Administrative Division costs indirectly through their inclusion in the reimbursement rates the institutions received for providing Medicaid and Medicare services.[28]

Kansas also argues that its allocation was equitable because State medical institutions had their own directors, executive staffs, and administrative support divisions, including human resources, procurement, budget, and information technology, in contrast to the other SRS divisions that were allocated costs which do not have their own executive support staffs and must rely on the SRS Administrative Division for their support. Kansas Ex. 2, ¶ 14; Kansas Ex. 39, ¶ 7. An audit workpaper reflects SRS staff comments that the State medical institutions were once independent agencies that brought with them their own

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[27] As discussed with respect to KRS Central Office costs, Table D of the CAP is titled "Distribution of Central Office Costs." Table D1 of the CAP as amended effective for FY 2000 states, "[d]istributes central office costs for PCA 61110, MHDD Administration, to PCA 61210, Mental Health Administration, and PCA 61310, Developmental Disabilities Administration, using headcount as a distribution method." Kansas Ex. 7. For FYs 1998 and 1999, Table D1 states, "[d]istributes central office costs for VR and MHDD [PCA 61110] using headcount as a distribution method." Kansas Ex. 8. Both versions state that headcount is determined by using information taken from SHaRPs which indicates the number of FTE staff positions. Id.

[28] The comments state that medical institutions differ from the rest of SRS because they are Medicaid/Medicare providers that are paid a per-diem rate based on cost reports, including "the home office cost report" that charges SRS indirect costs to the State medical institutions. Kansas Ex. 14, at E-5 — E-6. "In Table A of the KR-SRS cost allocation plan, expenses such as Executive, Human Resources, etc. are charged to HCP [SRS Division of Health Care Policy] or formerly to MHRS in the old organizational structure. In the *home office cost report* some of these indirect expenditures, along with other allowable expenditures in HCP, are charged back through their daily rate. Though not directly charged in the KS-SRS cost allocation plan, the central office costs are included in the State Medical Institutions' daily rate." Id. (italics in original).

administrative support staff when they became part of SRS. Kansas Ex. 6, at 2.

Analysis

The CAP's allocation of SRS Administrative Division costs to "PCA's which are administrative in nature" did not permit Kansas to exclude FTEs at State medical institutions from the allocation base for the distribution of those costs. The State medical institutions are components of MHDD, and Kansas reports that it allocated SRS Administrative Division costs to the PCA for MHDD (PCA 61110) because it was administrative in nature. Kansas Ex. 2, ¶¶ 2, 14. The CAP allocates costs to PCAs based on FTE headcount which, as discussed earlier, includes all FTEs within a given component. Kansas Ex. 9; Kansas Ex. 14, at 7. The CAP thus requires that FTEs at the State medical institutions be counted among the total FTEs at MHDD for the purpose of allocating SRS Administrative Division costs.[29]

Whether the State medical institutions themselves are considered "administrative in nature" is not the issue. As we discussed earlier, "administrative" cost centers such as MHDD may accumulate costs of administrative services for further allocation among cost objectives, such as the State medical institutions and the programs they administer. The CAP's inclusion of FTEs from the State medical institutions in the MHDD allocation base was appropriate because the extent to which MHDD utilized SRS administrative services was related to the total number of FTEs in MHDD. The record describes SRS administrative services as support provided to all SRS employees, including human resources, staffing-related assistance, legal support for personnel issues, and staff training in issues relating to HIPAA, time management, leadership skills, and avoidance of sexual harassment. Kansas Ex. 3, ¶ 10; Kansas Ex. 6, at 2; Kansas Ex. 14, at 7. The amount of such services that SRS must provide is logically a function of the number of personnel on whose behalf they are furnished, including personnel at the State medical institutions. Allocation of costs of those services on the basis of the total FTEs at MHDD assures that cost objectives within MHDD, including the State medical institutions and the programs they administer, will be allocated costs in accordance with relative benefits as required by the cost principles.

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[29] Kansas's annotations on cost allocation worksheets show the 2,499 FTEs at the State medical institutions as included in PCA 61110, the PCA for MHDD. Kansas Ex. 34.

Because we find that the CAP does not explicitly exclude from the headcount to be used as a distribution base the FTEs from the State medical institutions, we do not accept Kansas's argument that DCA knew when it approved the CAP that Kansas would not allocate costs to the institutions. To the extent that DCA could have divined from Kansas's organizational chart and the CAP language that the State medical institutions would receive services from the SRS Administrative Division, DCA could reasonably have assumed that the institutions would be allocated their fair share of the costs of those services. Moreover, Kansas provided no evidence that its documentation in support of its CAP showed that FTEs from the medical institutions would be excluded from the distribution base and does not deny that these FTEs are included in SHaRPs as MHDD employees.

The mere fact that some costs of SRS Administrative Division services may have been included in the institutions' indirect costs (and, ultimately, in their reimbursement rates) is irrelevant. There is no dispute that some SRS Administrative Division costs were allocated to an MHDD administrative account for further allocation to benefitting cost objectives. The issue is the amount of SRS Administrative Division costs that, under the CAP, should have been allocated to MHDD (rather than KDDS and other cost objectives). Clearly, that amount was understated as a result of Kansas excluding the State medical institutions from the distribution base.

We note that the record does suggest that the SRS Administrative Division furnished less support to the State medical institutions than to other SRS components, as Kansas contends. An audit workpaper states that the DCA senior negotiator told the auditors that in other states with similar organizational structures the medical institutions are "unique" and do not benefit in the same way as other components in the state agencies.[30] Kansas Ex. 6, at 2-3. As a result, to avoid allocating disproportionate costs to the medical institutions, those states negotiate an allocation method based on only a percentage of the institutions' FTEs. The DCA senior negotiator stated that this allocation method must be spelled out in the state plan, to which the agency must adhere.

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[30] Conversely, the costs at issue here might not have included the costs of some of services, such as information technology (IT), that the State medical institutions provided for themselves, according to Kansas. Kansas Ex. 39, ¶ 7. IT costs are allocated based on a time study, unlike the costs at issue here that were allocated based on FTEs, so IT costs were not among the disallowed costs. Kansas Ex. 14, at 7-8.

Id. To the extent that Kansas's CAP required allocation to the State medical institutions on the same basis as to other cost centers, however, Kansas is bound by the CAP until it is amended. Having adopted a method in a CAP, Kansas may not simply ignore it and substitute its own method. Given the negotiator's statements, however, our decision would not preclude an agreement between DCA and Kansas amending the CAP method prospectively to better reflect the relative benefits. Absent such an agreement, however, we uphold this portion of the disallowance.

Conclusion

As explained above, we conclude as follows:

- We remand the disallowance of KRS Central Office costs for FYs 2000-2002 to SSA so that it can confer with DCA about whether DCA considers the approved cost allocation plan amendment to contain a material defect, and if so, to permit Kansas an opportunity to resubmit to DCA a proposed cost allocation plan amendment that can be approved for this period that would fully reflect the relative benefits each office or agency received from the services. If Kansas disagrees with DCA's determinations on any of these remanded issues, it may appeal to the Board within 30 days of receiving any notice of a determination from DCA.

- We uphold in principle the disallowance KRS Central Office costs for FYs 1998 and 1999, but we remand the disallowance for this period, and for FYs 2000-2002, to SSA so that it can confer with DCA concerning the FTE counting issues raised by the parties and how to implement the plan methodology in a manner consistent with the applicable principles of cost allocation and the language of the plan.

- After the consultation with DCA has been completed, SSA may then re-compute the disallowance as follows: (1) SSA may re-compute the disallowance of KRS Central Service costs for FYs 2000-2002 applying the terms of either the new plan amendment or the original plan amendment if DCA determines that it does not contain a material defect; (2) SSA may re-compute the disallowance of KRS Central Service costs for the entire period on the basis of DCA's recommendation concerning how to implement the cost allocation plan methodology in a manner consistent with the applicable principles of cost allocation and the language of the plan (and, if applicable, a determination by DCA that any amended allocation methodology that it approves effective as of FY 2000 should also be applied for the earlier period).

- If Kansas disagrees with SSA's re-computation of the disallowance, Kansas may appeal to the Board within 30 days of receiving notice of SSA's determination.

- During this process, when SSA consults with DCA concerning any of the issues in dispute between the parties, SSA should provide Kansas with an opportunity to present its position and supporting evidence.

- We uphold the disallowance of $621,288 in SRS Administrative Division costs.

Judith A. Ballard

Sheila Ann Hegy

Donald F. Garrett
Presiding Board Member