



Grantee Owes Feds Amounts Received as "Applicable Credits"

Michigan Department of Management and Budget, DAB No. 1994 (September 16, 2005)

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By Kirsten Feroe, CAPLAW

In this case, the DAB concluded that a federal grantee owed the U.S. government a cash refund of amounts it received as "applicable credits." The DAB affirmed the determination by the U.S. Department of Health and Human Services' Division of Cost Allocation (DCA) that the federal government was entitled to a cash refund of its share of funds collected by the state of Michigan, through the state's Department of Management and Budget (MDMB), from the Boise Cascade Corporation under a contract to provide office supplies to Michigan state agencies. The MDMB provides a variety of centralized services to Michigan agencies, some of which operate programs that are administrated under federal awards. Under the contract with Boise Cascade, Michigan's operating agencies purchased office supplies directly from Boise Cascade at a 50 percent discount off all general catalog items, but were assessed a five percent user fee on all items purchased. The terms of the contract also required Boise Cascade to remit to MDMB, promptly after the end of each billing period, a payment equal to the user fees paid by the operating agencies during the billing period. Funds collected by the MDMB under the Boise Cascade contract were used to finance other centralized services, including purchasing services and paper recycling costs.

DCA determined that the fees were rebates from Boise Cascade and that Michigan owed the federal government a cash refund equal to the portion of the fees corresponding to the office supply costs the state charged to its federally funded programs, plus interest. DCA made its determination under OMB Circular A-87, which establishes uniform principles for determining the costs that state, local, and Indian tribal governments may charge to federal awards. Circular A-87 provides that the program costs that a grantee may charge to a federal award consist of the program's allowable direct costs, plus the program's allocable share of allowable indirect costs, less "applicable credits";¹ to the extent that an applicable credit relates to an allowable cost, a grantee is required to credit the federal award or issue a cash refund.² OMB Circular A-87 defines "applicable credits" as:

those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges.³

Michigan contended that the disputed Boise Cascade funds did not constitute "applicable credits" as defined by Circular A-87. It argued that the funds were properly characterized not as rebates, but as "user fees" that were unrelated to the price discounts negotiated with the vendor. The state claimed that using Boise Cascade to collect the user fees was an "accurate and efficient method for allocating costs" of purchasing services and recycling and that "using a vendor to collect our user fees does not automatically make that fee a rebate, nor convert otherwise allowable costs, to unallowable costs."

The DAB affirmed the DCA's determination, modified slightly as to the amount of cash refund owed to the federal government. In finding the requisite "direct link, or nexus" between the credit to the MDMB and the amount to which it had to be applied, the DAB emphasized that the focus on any given transaction is its substance, rather than its label. Although it was undisputed that Michigan agencies incurred costs to purchase office supplies under the contract, the DAB noted that the cost principles in Circular A-87 provide specifically that the federal government's participation in these costs is limited to the "actual prices" of the office supplies. The "actual price" in A-87 is "one that reflects all discounts, rebates, or allowances." Here, although the full amounts of the payments made to Boise Cascade were charged to federal awards as costs of office supplies, these payments exceeded the actual costs to Michigan of the supplies, since Boise Cascade returned a portion of the payment. "In short," the DAB wrote, "there was a direct and close relationship between MDMB's receipt of funds from Boise and the incurrence of expense items - namely, the purchase of office supplies by Michigan agencies - claimed under federal awards."

Although it focuses on the requirements of OMB Circular A-87, which applies to state and local government grantees, this DAB decision is equally relevant to nonprofit grantees. The rules on applicable credits contained in OMB Circular A-122, the cost principle circular that applies to nonprofit grantees, are essentially the same as those in Circular A-87.⁴

¹ OMB Circular A-87, Att. A, § D, ¶ 1.

² OMB Circular A-87, Att. A, § D, ¶ 4.a.

³ *Id.*

⁴ See OMB Circular A-122, Att. A, § A, ¶¶ 1 and 5.a.