

BEFORE THE  
MARYLAND STATE BOARD OF CONTRACT APPEALS

Appeal of KHI Services, Inc. )  
 )  
Under Department of Juvenile ) Docket No. MSBCA 1691  
Services Audit Appeal (T.O.Y.C.) )

March 1, 1993

Interpretation of Contracts - Objective - Where the contractor has a clear and definite contract requirement to account for contract revenue the Board of Contract Appeals will enforce such requirement.

APPEARANCE FOR APPELLANT: Lydia D. Koutze, Exec. Dir.  
KHI Services  
Rockville, MD

APPEARANCE FOR RESPONDENT: Robert T. Fontaine  
Asst. Attorney General  
Baltimore, MD

OPINION BY MR. MALONE

Appellant KHI Services, Inc. (KHI) timely appeals the denial of its defense to an affirmative claim for \$12,006.00 by the Department of Juvenile Services (DJS) resulting from an audit of its contract for the operation of the Thomas O'Farrell Youth Center (T.O.Y.C.). The parties filed documents and stipulations and have waived a hearing asking the Board to rule on the record.

Findings of Fact

1. KHI contract no. 58484 with DJS operated the T.O.Y.C. during the three fiscal years 1987, 1988 and part of 1989, with total expenses of \$1,536,172.00.<sup>1</sup>

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<sup>1</sup>The "costs" of the contract were arrived at by KHI on May 8, 1990 by the direct costs \$1,263,559.00 plus indirect costs of 18.53% (\$287,349.00) for a total of \$1,550,908.00. No reason is given for using 18.53%. Then on October 16, 1990 the costs were recalculated using 23.35% indirect cost for 1987 and 22.33% indirect cost for 1988. 18% was used in KHI's original proposal.

DJS ultimately accepted \$292,309.00 as indirect costs. The record is unclear why these amounts were accepted by DJS or why the overrun of budget was accepted; i.e. (\$259,466.00 estimated indirect vs \$292,309.00 indirect cost accepted by DJS). The

2. KHI was to operate the center and be paid by a draw down process up to a budgeted yearly amount. KHI was to submit quarterly invoices for "reasonable, allowable and allocable costs and expenses itemized in a manner satisfactory to DJS". Quarterly payments would be made to KHI based upon a detailed request which could include direct and indirect costs acceptable to DJS.

3. KHI received payments from DJS totaling \$1,518,853.00. Some of these payments were placed into an interest bearing account and KHI earned \$11,920.00 in interest. The contract provides interest under the contract must be "reported to the Department as additional income."<sup>2</sup>

4. The contract required that funding for this contract "must be maintained and accounted for separately from any other grants, contracts or fiscal entities operated or controlled by KHI." KHI received \$29,104.00<sup>3</sup> from the Maryland State Department of Education (MSDE) under a separate grant to be used for the food and nutrition program for youth at T.O.Y.C., and contrary to the contract requirement for separate accountability co-mingled these funds with contract No. 58484 funds.<sup>4</sup>

5. The contract required KHI to keep its books and records so that "accounting documents pertaining in whole or in part to the agreement shall be clearly identified and readily accessible" and that all cost records "shall be supported by properly

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Board understands the reason for estimating indirect costs during the contract performance for payment of draw downs but when the contract is complete, an audit to determine the exact costs of the project is contemplated by the contract to "reveal that funds [which] were not expended . . . should be returned to the Department." The parties stipulated KHI had documented expenses of \$1,536,172.00.

<sup>2</sup>The parties stipulated KHI refunded \$9,380.00 to DJS.

<sup>3</sup>The Board notes a review of the record reflects a MSDE supplemental payment of \$30,359.00 on 9/25/87, where the exact \$29,104.00 figure comes from is problematical, but is a stipulation of the parties.

<sup>4</sup>The Board notes that as early as April 14, 1987 KHI was informed by letter that the federal child nutrition of \$30,359.00 under the Child Nutrition Act would be an accountable fund source for this contract and to keep records to reflect this funding earned by DJS.

executed payrolls, time records, invoices, contracts or vouchers, or other official documentation evidencing in proper detail the nature and property<sup>5</sup> of the charges."<sup>6</sup>

6. KHI accounting method does not allow the trace of any specific cost against any specific revenue. The DJS initiated audit process with KHI which concluded on May 9, 1991 indicated that \$31,082.00<sup>7</sup> was due from KHI to DJS.<sup>8</sup> The parties continued to discuss the audit process and as a result of such discussions and consideration of all adjustments for direct and indirect costs DJS now claims \$12,006.00. The parties stipulated \$1,518,853 was paid by DJS to KHI, and \$29,104.00 KHI by MSDE for a total of \$1,547,957.00. The \$221.00 difference from the \$1,548,178.00 found by the Procurement Officer was a credit for expenditures for commodities not allowed by the audit provided by MSDE to KHI. The total expenses of \$1,536,172.00 less \$1,547,957.00 is \$11,785.00. If

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<sup>5</sup>While the contract reads "property" the Board opines the word "propriety" results in a more appropriate spelling given the context of the sentence.

<sup>6</sup>In November 24, 1991 KHI explained it had taken direct costs such as audit fees, rent, recruitment, mileage, liability, depreciation, salaries, and put these into indirect costs since "they could not be isolated in direct costs to the O'Farrell program."

<sup>7</sup>KHI originally argued that since the \$31,082.00 claim of DJS (now reduced to \$12,006.00) represented approximately 10% of the budgeted indirect costs estimate of \$259,466.00 such amount should be assumed as having been "legitimately spent" at T.O.Y.C. without any documentation of such assumption.

<sup>8</sup>The audit process reflects continued recalculation of the amounts claimed by DGS.

October 2, 1992 DJS claimed \$12,006.00.  
October 24, 1991 DJS claimed \$34,032.00.  
May 8, 1990 DJS claimed \$50,097.00.  
April 20, 1989 DJS claimed \$273,490.00.  
August 15, 1988 DJS claimed \$115,357.00.

\$11,735.00 is added to the \$221.00 the claimed amount of \$12,006.00 is derived.

7. KHI records can not trace costs and related revenues in light of this DJS has used a method of reconciling the account by total revenue in and total allowed costs out. When this comparison is made there is a \$12,006.00 refund due to DJS. DJS argues that since KHI treated the \$29,104.00 from MSDE as income under this contract they must account for it by costs going out of this contract.

8. The parties agree that MSDE food nutrition funds were supplemental dollars and were properly "accounted" for in a separate MSDE audit issued January 4, 1990.<sup>9</sup> KHI argues since the income comes from MSDE it does not have to account for these funds under Contract No. 58484. As noted above DJS argues that since KHI treated the \$29,104.00 from MSDE as income under contract No. 58484 it must account for the use of this money under this same contract since to allow otherwise would result in "double billing". In the alternative KHI argues that \$24,082.00 is owed to it by DJS under another program which should be used to set off the amount claimed by DJS in Contract No. 58484. However, any claim that may have been under such other program is not before the Board.

#### Decision

The contract language clearly requires KHI to keep separate records. KHI chose to account for MSDE funds under this contract as income and has been allowed all but \$12,006.00 in direct and

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<sup>9</sup> KHI's audit with MSDE was based in part on "meal counts", were KHI would claim so many breakfasts, and lunches were provided by attendance records allegedly kept by KHI. The report also indicated no separate records were kept and that program revenues were not properly kept. The audit was for the limited purpose of looking at KHI's system of internal controls. There is no indication actual costs and revenues were traced or cross referenced with the improperly co-mingled funds. In short this "audit" aids little to supporting the view of KHI but rather supports DJS's position that KHI records were not properly kept on other contracts.

indirect expenses against that income. The record supports the Procurements Officer's finding that \$12,006.00 is due and owing to DJS. KHI did not comply with contract accounting requirements to keep separate the funding of this project from other projects. DJS was left with no alternative but to compare total income into the account against total allowable costs out of the account. See, Dr. Adolph Baer, P.D. and Apothecaries, Inc. MSBCA 1289, 2 MICPEL 146(1987) and Dominion Contractors, Inc. MSBCA 1041, 1 MICPEL 69(1984).

The Board will not renegotiate the agreement of the parties. This Board in applying the objective test of contract interpretation finds that KHI had a clear and definite contract requirement to account for the entire amount of contract revenue. See, Fruin-Colnon Corporation and Horn Construction Co., Inc. MDOT 1001, 1 MICPEL 1(1979) and Baltimore Washington Services, MSBCA 1539, 3 MICPEL 261(1990). The objective test is the controlling law in Maryland procurement. The rule in Maryland was stated in State Highway Admin. v Greiner, 83 Md. App. 621(1990) at pgs. 638-639 as follows;

"Our holding is in account with the objective law of contracts as applied in General Motors Acceptance Corp. v. Daniels, 303 Md. 254, 492 A.2d 1306 (1985). In General Motors the Court described the objective law of contract interpretation and construction as follows:

A court construing an agreement under this test must first determine from the language of the agreement itself what a reasonable person in the position of the parties would have meant at the time it was effectuated. In addition, when the language of the contract is plain and unambiguous there is no room for construction, and a court must presume that the parties meant what they expressed. In these circumstances, the true test of what is meant is not what the parties to the contract intended it to mean, but what a reasonable person in the position of the parties would have thought it meant. Consequent-

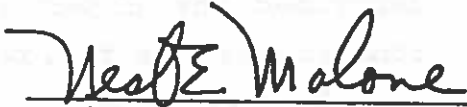
ly, the clean and unambiguous language of an agreement will not give away [sic] to what the parties though that the agreement meant, or intended it to mean. As a result, when the contractual language is clear and unambiguous, and in the absence of fraud, duress, or mistake, parol evidence is not admissible to show the intention of the parties or to vary, alter, or contradict the terms of that contract."

Further, the Board cannot look to the efficacy of possible contract set off or counter claims when those claims are not before the Board or the Procurement Officer. KHI makes an allegation in a July 21, 1992 letter that due to a "premature cancellation" of some other contract KHI has a possible claim of \$24,082.00. It is the responsibility of KHI to properly bring a claim to the Procurement Officer and if aggrieved to this Board. The Board cannot speculate as to the merits of any claims KHI may maintain.


See, Dewberry & Davis/Phillips Swager Associates, a Joint Venture, MSBCA 1365, 2 MICPEL 176(1988).

The Board sustains the claim of DJS for \$12,006.00 against KHI together with pre-decision interest of 10% from October 2, 1992 the date of the Procurement Officer's decision until paid.

Dated: March 1, 1993

  
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Neal E. Malone  
Board Member

I concur:

  
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Robert B. Harrison III  
Chairman

  
Sheldon H. Press  
Board Member

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I certify that the foregoing is a true copy of the Maryland State Board of Contract Appeals decision in MSBCA 1691, appeal of KHI Services, Inc. under Department of Juvenile Services Audit Appeal (T.C.Y.C.).

Dated: *March 1, 1993*

  
Mary F. Priscilla  
Recorder

