Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: California Department of Health Services
Docket No. A-96-27
Control No.CA-95-006-ADM
Decision No. 1606

DATE: December 18, 1996

DECISION

The California Department of Health Services (California) appealed a determination by the Health Care Financing Administration (HCFA) disallowing $706,850 in federal financial participation (FFP) claimed under title XIX (Medicaid) of the Social Security Act for the period July 1, 1991 through June 30, 1992. HCFA determined that California had claimed the enhanced rate of 75 percent FFP, available for costs attributable to the operation of California's Medicaid Management Information System (MMIS), for all payments (except postage) made to its fiscal agent, Electronic Data Systems (EDS), for its Provider Relations Group. HCFA found that the payments covered some functions not attributable to the operation of the MMIS.

HCFA based its determination on an audit performed by the HHS Office of Inspector General, Office of Audit Services. In a March 1995 report, the auditors determined that while some of the functions performed by the Provider Relations Group (PRG) were eligible for funding at the enhanced 75 percent rate, a substantial portion of the functions was eligible only for the general administrative rate of 50 percent FFP. California had submitted a blanket claim for 75 percent enhanced FFP for its fixed price payments to EDS for the PRG and did not distinguish between the functions performed by the PRG which qualified for the 75 percent rate and those functions which qualified for the 50 percent rate. HCFA determined that California failed to document its claim for enhanced FFP in the payments for EDS' PRG for the period in dispute and therefore disallowed an amount equal to the difference between

California's claim at the enhanced 75 percent rate of FFP and the 50 percent rate.

California acknowledged that not all the functions performed by the PRG were functions entitled to the enhanced rate attributable to operation of the MMIS. Therefore, the question before us is whether California has met its burden of showing how much of its claim is entitled to reimbursement at the enhanced rate of 75 percent. The Board has previously held in a variety of contexts that where a state is claiming reimbursement at a rate higher than the 50 percent rate generally available for administrative costs, the state has the burden both to document the costs claimed and to show that it is entitled to the higher rate. For the reasons discussed below, we conclude that California failed to document what portion of the claim for the EDS PRG in fact qualified for enhanced funding. We further conclude that there is no basis for allowing reimbursement of California's claim at the 75 percent rate in the absence of such documentation, and, accordingly, we uphold the disallowance in full. We note that notwithstanding the disallowance, there is no dispute that California is entitled to 50 percent reimbursement for its claim.

Applicable law, regulations and guidelines

In 1972, Congress amended title XIX to include enhanced rates of reimbursement for administrative costs for the operation of a mechanized claims processing and information retrieval system. Section 1903(a)(3)(B) of the Act provides for reimbursement of --

> 75 per centum of so much of the sums expended during such quarter as are attributable to the operation of [mechanized claims processing and information retrieval systems] . . . .

An MMIS qualifies as such a system. The regulations at 42 C.F.R. § 433.111(b) define an MMIS as --

> a system of software and hardware used to process Medicaid claims from providers of medical care and services for the medical care and services furnished to recipients under the medical assistance program and to retrieve and produce service utilization and management information required by the Medicaid single State agency and Federal Government for program administration and audit purposes.

The regulations at 42 C.F.R. § 433.15(b)(4) reiterate that the 75 percent rate of FFP applies to the

"[o]peration of mechanized claims processing and information systems." "Operation" is defined as --

> the automated processing of data used in the administration of State plans for . . . Title XIX of the Social Security Act. Operation includes the use of supplies, software, hardware, and personnel directly associated with the functioning of the mechanized system. . . .

45 C.F.R. § 95.605.

Section 1903(a)(7) of the Act and 42 C.F.R. § 433.15(b)(7) provide that all activities not qualifying for enhanced funding that are necessary for the proper and efficient operation of the State plan may be reimbursed at the 50 percent rate.

Furthermore, the State Medicaid Manual (SMM) at Part 11 sets forth applicable HCFA policy concerning the MMIS and which costs are appropriately claimable at the enhanced rates of reimbursement.[1] The SMM makes clear that the enhanced 75 percent rate is available only for those functions attributable to MMIS operations and states that, "[f]or example, with respect to provider enrollment, only the costs of entering data into the computer system and processing computer exceptions would be reimbursed at 75-percent FFP." SMM section 11276.1. That section further explains that other functions, even if performed by the same unit or individuals, are reimbursable only at 50 percent FFP. Section 11276.3 further provides:

> Costs Reimbursable at 75-Percent FFP.--FFP at 75 percent is available for direct costs directly attributable to the Medicaid program for ongoing automated processing of claims, payments, and reports. Included are forms, system hardware and supplies, maintenance of software and documentation, and personnel costs of operations control clerks, suspense and/or exception claims processing clerks, data entry operators, microfilm operators, terminal operators, peripheral equipment operators, computer

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[1] We cite here to Revision 11 to Part 11 of the State Medicaid Manual, which was effective June 29, 1990 and therefore applicable to the time period in dispute here. We note that Part 11 was first issued in July 1981 and replaced the provisions of the Medical Assistance Manual issued in June 1974 (PRG-31) and a HCFA Action Transmittal, HCFA-AT-78-33, issued in April 1978.

> operators, and claims coding clerks if the coded data is used in the MMIS, and all direct costs specifically identified to these cost objectives. Report users, such as staff who perform follow-up investigations, are not considered part of the MMIS.
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> FFP at the 75-percent level for operations does not cover clerical processing operations, except as indicated. One of the aims of system improvements is the mechanization of front-end manual editing operations to achieve greater edit reliability and the reduction of clerical workload.

Section 11276.10 of the SMM provides:

> Costs Reimbursable at 75-Percent FFP for Fiscal Agent MMIS Operations.-- A fiscal agent may perform many additional functions (see §11276.7) for the State beyond those related to MMIS operations eligible for 75-percent FFP, yet bill the State at one all-inclusive rate per claim processed. If this is the case, develop a cost allocation plan through which payments to the fiscal agent are broken out for matching at the appropriate FFP rates. . . .

The SMM at section 11276.11(B)(2) contains a list of functions or activities for which enhanced FFP is available. That section further states that only items listed for the 75 percent rate of funding qualify for enhanced FFP as expenditures for MMIS operations under section 1903(a)(3) of the Act. Under the list of functions reimbursable at 75 percent FFP, this section specifically provides that "Provider relations directly related to MMIS claims processing, such as, entry and update of provider data" are eligible for 75 percent FFP. Section 11276.11(B)(3) states that costs of producing Provider Manuals are reimbursable only at 50 percent FFP.

It is also well settled in Board precedent that enhanced reimbursement is available only for functions which benefit the ongoing operation of a mechanized information system. See Pennsylvania Dept. of Public Welfare, DAB No. 832 (1987), at 12. The Board stated that the SMM --

> refers simply to functions which are of direct benefit to the MMIS. Consequently, functions which would occur regardless of the MMIS, simply because providers submit claims, are not functions which . . . warrant the incentive of an enhanced rate of

> reimbursement. It might always be necessary to have staff available to answer provider inquiries about billing problems . . .

DAB No. 832 at 12.

Factual Background

This is the third Board decision addressing claims by California at the enhanced FFP rate of 75 percent for payments to a fiscal intermediary for operation of an MMIS.[2] See State Brief at 1. Here, the auditors had determined that California claimed enhanced FFP for all payments made to EDS under the MMIS contract for PRG costs (except postage), totalling $2,827,400, even though not all the functions performed by PRG personnel were directly attributable to the operation of the MMIS.[3] The auditors determined that this resulted in an overclaim of federal funds of $706,850 (25 percent of $2,827,400), representing an amount equal to the difference between the 75 percent FFP claimed and the 50 percent FFP to which California was allegedly entitled. The auditors noted that while some of the functions performed were allowable at the 75 percent rate, neither California nor EDS had maintained any kind of documentation or records which would indicate the actual amount of time staff spent on the different functions. State Ex. A. By

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[2] The Board has upheld two previous disallowances concerning costs associated with California's MMIS and its fiscal intermediaries. See California Dept. of Health Services, DAB No. 1274 (1991) (upheld in Coye v. Sullivan, No. CIV S-92-009 (E.D. Cal. Feb. 11, 1993)), which involved indirect costs, and California Dept. of Health Services, DAB No. 1539 (1995), which involved costs associated with the provider relations group of California's Medicaid dental fiscal agent.

[3] The MMIS contract between California and EDS set a fixed price for PRG activity. EDS billed California in two ways. First, EDS billed most of the costs based on an all-inclusive rate per claim line processed, called the adjudicated claim line. The EDS contract specified that 10 percent of the adjudicated claim line costs were to be identified and billed as provider relations costs. Second, EDS billed the costs of the Appeals Support Group and the Toll-Free Telephone Group based on an all-inclusive fixed hourly rate for each position in the group. State Ex. A at 6.

letter dated September 21, 1995, HCFA adopted the auditors' recommendation to disallow $706,850.

Analysis

California appealed this disallowance on two principal grounds: (1) the audit performed by the OIG auditors was inadequate and erroneously concluded that a substantial percentage of the total activities actually performed by staff of the PRG did not qualify for enhanced FFP at the 75 percent rate; and (2) it is arbitrary and unreasonable for HCFA to disallow the difference between California's claim at the 50 percent rate and the 75 percent rate when a time study could be conducted now to support an allocation of costs incurred during the disallowance period.

We find no merit to California's argument regarding the adequacy of the audit. California contended that the auditors' finding that "substantially" all the functions performed by the PRG were not functions directly attributable to the operation of the MMIS was inaccurate and was based on the auditors' limited observations of only part of the PRG. California argued that the auditors thus missed the fact that a substantial number of the functions performed by the PRG do qualify for enhanced funding and that consequently HCFA had no reasonable basis for taking this disallowance.

This argument misses the essential point, however. California did not offer any evidence that refutes the basic finding of the audit that the PRG was performing some functions that were ineligible for enhanced funding. California also admitted that it is not entitled to reimbursement at the enhanced rate for non-MMIS operational functions. Moreover, section 11276.10 of the SMM clearly informed states that where a state contracts with a fiscal agent and that agent performs additional functions for the state beyond those related to MMIS operations eligible for 75 percent FFP, billing the state at one all-inclusive rate, the state must develop a cost allocation plan by which payments to the fiscal agent are broken out for matching at the appropriate rate of FFP. California had no such allocation plan. Furthermore, California admittedly has no documentation for the time period at issue here that would show or support an allocation of PRG staff time between enhanced functions

and non-enhanced functions.[4] State Brief at 19. Moreover, there is no contemporaneous basis for assessing what portion of the contract cost would properly be allocable to enhanced activities.[5] Therefore, once the auditors determined that non-MMIS operations functions were being performed, even if after reviewing only one part of the PRG, the auditors were under no obligation to look any further. Since there was no basis for distinguishing costs that may have been attributable to the operation of the MMIS from those that were not, all of the PRG costs in excess of the 50 percent rate were properly disallowed. It was not the auditors' responsibility to determine what percentage of time each employee in the PRG spent on enhanced functions and non-enhanced functions and to try to relate that time to the contract price for PRG services.

It is a fundamental principle that a state has the initial burden to document its costs and to show that its claim for reimbursement is proper, especially showing that its claim qualifies for an enhanced funding rate and meets any special conditions for that rate. See

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[4] California presented declarations from eleven EDS employees in the PRG to establish that a "substantial" number of the functions performed were entitled to the enhanced rate of reimbursement. As we point out here, whether a "substantial" portion of the functions performed was attributable to MMIS operations is beside the point. Moreover, these declarations, made four years after the fact, are neither contemporaneous nor sufficiently detailed to document what part of the costs at issue are properly attributable to MMIS operations. See DAB No. 1539 (1995). In addition, we need not reach the question of which functions would qualify for enhanced funding, in light of our determination, discussed in the text below, that California's prospective time study is not a reasonable basis for developing an allocation of the amount of time spent on various functions by PRG employees for the time period at issue.

[5] This is an important point. Even if we found that 50 percent of PRG staff time was spent on enhanced activities, there is no reason to conclude that 50 percent is the proper allocation since each staff member's functions and time are not necessarily reflected equally in the contract fixed price. Even if staff time could be determined, the question remains of how to reflect this time in the allocation of the total fixed price.

California Dept. of Health Services, DAB No. 1539, at 7-8 (1995); New York Dept. of Social Services, DAB No. 204 (1981). Thus, it was California's responsibility to determine initially whether the fiscal agent's PRG would in fact be performing non-enhanced functions and, if so, to develop a valid cost allocation plan. Whether the amount of functions performed which were not directly attributable to MMIS operations was "substantial" or not is therefore beside the point. Since there were at least some functions which were not directly attributable to MMIS operations, the audit was sufficient to show that California was required to allocate its contract costs. Accordingly, we find no reason to conclude that either the audit or the resulting disallowance was somehow compromised because only some of the units of the PRG were reviewed.

California also asked us to find that it was unreasonable for HCFA to disallow all the enhanced funding California claimed "when a time study conducted in the present can easily be applied to the retroactive period of the disallowance." State Brief at 3. In asserting this equitable argument, California claimed that the current functions of the PRG units are substantially similar to the functions performed in the disallowance period. State Brief at 3; Transcript (Tr.) of Informal Conference at 31-32. California requested that we remand this matter back to HCFA to work with California to refine a methodology to develop a matching rate for prospective use.[6] California asserted that the methodology could be

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[6] To document its PRG costs prospectively, California proposed to HCFA a time study methodology that would identify the percentage of time spent by EDS employees in the PRG on various activities and to calculate the percentage of employee time spent on activities matchable at the enhanced rate. State Ex. E. The time study proposed would identify the universe of activities performed by each position in the PRG. These activities, called "time card categories," would be customized to the individual activities of each position with the exception of the managerial level and clericals, whose time would be claimed based upon the time study results of the sampled employees. State Ex. E at 2. Under this methodology each sampled employee would maintain a daily time study of productive time for a two-week period. Vacation, sick, and leave time would be allocated to productive employee hours based on employee records. Then, an aggregate percentage of time for enhanced and non-enhanced activities would be allocated

(continued...)

adapted so that it could be applied retroactively to the period of the disallowance, a practice referred to as backcasting, based on California's premise that there were no significant differences in the activities performed by the EDS staff to be surveyed in the present period and those activities performed in the retroactive period. State Ex. 2 at 1.

There are several flaws in California's argument. First, California's argument asks us to overlook its failures to allocate its PRG contract costs in accord with the applicable regulations and guidelines and to meet its burden of documentation. There is no basis for doing so especially since California has been in similar circumstances before. DAB No. 1274 also dealt with a blanket claim at 75% for fiscal agent costs. In that decision, we discussed at length the pertinent provisions of the SMM. We explained why the SMM provisions were a reasonable interpretation of the statutory term "attributable" when addressing why operational MMIS activities must be closely related to actual systems operations. We stated that since the requirement at issue concerns an enhanced rate of FFP and is an exception to the reimbursement rate for administrative activities generally, the requirement may properly include reasonable limits to differentiate costs subject to the ordinary rates from costs entitled to enhanced funding. We also recognized that the enhanced rate is

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[6](...continued)
for all employees participating in the time studies and the aggregate percentage would be applied to the PRG invoice to calculate the FFP rate.

By letter dated April 26, 1996, HCFA made several comments regarding the proposed allocation method for use prospectively in documenting PRG costs of the fiscal intermediary. HCFA stated that it needed to verify the accuracy of the time card categories listing activities for each position. HCFA also disagreed with certain allocation assumptions. HCFA indicated that it was necessary to relate the time allocations to employee salaries in order to "eliminate bias based on differences in . . . salaries." HCFA further determined that the proposed time study could not be used to derive allocation percentages applicable to any prior period, including the period in dispute here. HCFA based this decision on differences in the PRG organizational structure in 1991-92 and the lack of information about the way position functions were performed in the earlier period. HCFA Ex. 3.

intended as an incentive for states to develop and use a mechanized system. DAB No. 1274 at 8-9. In this case, California admitted that there are non-qualifying functions among the PRG activities which were included in the fixed price claimed. In light of the SMM's specific delineation of those activities that do qualify, California's purported belief that it could claim all its PRG activities at 75% was not reasonable. The applicable SMM provisions are not new. Thus California had no excuse for waiting until now to attempt to develop an allocation plan. In the absence of an allocation plan or contemporaneous supporting documentation, the claim as currently constituted is not sufficient because there is no basis which would allow HCFA or the Board to establish what portion of the contract cost for the PRG was attributable to non-enhanced functions. Any such allocation would be merely speculative.

Moreover, California is asking us to decide on the retroactive use of the results of a time study methodology which is admittedly intended for prospective use only and which has not been approved yet even for that purpose. In any event, California did not show that the circumstances under which the Board previously suggested that "backcasting" might be permissible exist here. One of the conditions for using such results is where the sample period is contiguous in time to the claim period. See Missouri Dept. of Social Services, DAB No. 1021 (1989); California Dept. Of Health Services, DAB No. 666 (1985). In this instance, California seeks to apply the results of a proposed time study methodology to be performed in the near future to a non-contiguous time period (July 1, 1991 through June 30, 1992). Moreover, the Board has stated that backcasting would be appropriate only if it can be established that circumstances in the sampled period are not substantially different from those in the retroactive claim period. Id. HCFA asserted that the fact that California proposed to adapt its prospective methodology to account for organizational changes indicates that there are differences between the two time periods. While California asserted that the changes were not substantial, the record shows that whole units have been moved out of the PRG and into other organizational components since the time period in question. State Brief at 19; State Ex. C. California nevertheless argued that the configuration of the PRG invoice which was the basis for the 1991-92 claim in question here could be easily "replicated," "simulated," or "reconstructed," as the same units performing the same functions exist today in the EDS. State Brief at 19; State Reply at 11; and Tr. at 32 and 37. As support for this argument,

California presented two affidavits from the former Director of the PRG during the period in dispute, which stated that the functions of the PRG today are "substantially the same" as in 1991-92. His opinion was based on a side-by-side comparison of the core responsibilities of the units in the PRG in 1991-92 and today as set forth in the applicable EDS contracts. State Exs. C and H. In addition, an EDS employee who worked on developing a proposal for the new EDS contract in 1992 and was familiar with the contract requirements during the period in dispute stated that, based on her comparison, the functions are "essentially the same." Tr. at 36. California's counsel further contended that the backcasting of its proposed methodology to the 1991-92 period would be an appropriate reconstruction because the functions of claim processing are repetitive, routine functions that do not change. She argued that the computer system (CAMMIS) has not changed and the amounts of the functions have not really substantially changed. Tr. at 37.

We do not find these arguments persuasive. In essence, California asks us to infer based simply on performance of the same functions that the time spent on those functions would be the same now as five years ago. California offered no objective, verifiable evidence of what the proportion of time spent on various functions within those units was in 1991-92 or whether it would have been the same in 1991-92 as it is today. For example, despite California's general allegation that its MMIS has not changed, the PRG's increased experience since 1991-92 in operating the MMIS and acting as fiscal agent might mean that employees spend less time now on certain functions than they might have during the period in dispute. As HCFA pointed out, even as modified, California's proposed methodology applied retroactively simply fails to account for the differences that may exist in the amount of time spent performing functions and any differences in the way functions were performed during the sampled period and the period in dispute. Moreover, it is unclear how the proportion of time now spent on enhanced functions could be used to allocate the fixed price contract cost from 1992-92 since there is no reason to conclude that all activities were weighed equally in the contract price. California did not meet its burden to demonstrate that data from 1996 or 1997 would be a reliable demonstration of its experience for the period at issue. Even if overall types of functions remained constant, there may have been changes in types of providers or types of care provided. California offered no evidence to show that the proportion of functions performed now would be the same as during 1991-

92. Therefore, we conclude that HCFA reasonably determined that backcasting by means of the proposed time study would not be appropriate for the period in dispute here, and decline to remand the case as requested by California.

Conclusion

For the reasons stated above, we uphold HCFA's disallowance in its entirety.

Judith A. Ballard
Judith A. Ballard

Donald F. Garrett
Donald F. Garrett

Cecilia Sparks Ford
Cecilia Sparks Ford
Presiding Board Member