DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Colorado Department of Social Services
Docket No. 79-18-CO-HC
Decision No. 218

DATE: September 30, 1981

DECISION

The Colorado Department of Social Services (State) appealed from a penalty disallowance in the amount of $10,909,718 made by the Health Care Financing Administration (Agency). The Agency determined that the State had violated the utilization control requirements of Section 1903(g) of the Social Security Act (the Act) during the period January 1, 1977 through June 30, 1978 (six quarters), and that the State did not meet the conditions for a waiver under Section 1903(g)(3)(B) of the Act. After the waiver provision was amended, the Agency determined that the State met the amended conditions for the quarters in 1977, and reduced the disallowance (Agency Memorandum, March 2, 1981). Thus, this appeal currently concerns a disallowance of $2,881,309 for the period January 1, 1978 through June 30, 1978 (two quarters). The issues center on the annual review requirement of Section 1903(g)(1)(D) and the effect of the waiver provision in Section 1903(g)(3)(B) on that requirement. We conclude, on the basis of the analysis set forth below, that the modified disallowance should be upheld.

This decision is based on the State's application for review, the Agency's response, two supplemental memoranda filed by the Agency, the State's amendment to its appeal, the Board's Order to Show Cause, and the parties' responses to the Order. We have determined that there are no material facts in dispute, and that a conference or hearing would not assist the development of the issues.

Background

Section 1903(g) of the Act requires that the State agency responsible for the administration of the State's Medicaid plan under Title XIX of the Act show to the satisfaction of the Secretary that the State has an "effective program of control over utilization of" long-term inpatient services in certain facilities, for each quarter that federal medical assistance is requested for such services, or the Federal medical assistance percentage (FMAP) must be decreased by an amount determined pursuant to the formula set out in Section 1903(g)(5). The State "must" show that it has "an effective program of medical review of the care of patients in ... [such] facilities pursuant to section 1902(a)(26) and (31) whereby the professional management of each case is reviewed and evaluated at least annually by independent professional review teams" (Section 1903(g)(1)(D)).

Sections 1902(a)(26) and (31) require that the State plan provide for a regular program of medical review (MR) in skilled nursing facilities (SNFs) and mental hospitals (MHs), and a regular program of independent professional review (IPR) in intermediate care facilities (ICFs); periodic inspections in all such facilities; and reports containing the findings and recommendations resulting from such inspections.

The applicable regulation, 42 CFR 450.23 1/, provided in some detail what a medical review should include: personal contact with and observation of each SNF patient and review of patient records, and a full report covering observations, conclusions, and recommendations of the review team, including specific findings about individual patients. These reports are to be followed by "appropriate action" on the part of the State. Furthermore, the reviews must be made "not less often than annually."

P.L. 95-59, enacted June 28, 1977, postponed any reductions required by Section 1903(g) for unsatisfactory showings prior to October 1, 1977. P.L. 95-142, enacted October 25, 1977, amended Section 1903(g) in several ways, including the addition of the waiver provision of Section 1903(g)(3)(B). P.L. 96-499, the Omnibus Reconciliation Act of 1980, December 5, 1980, amended Section 1903(g)(3)(B).

Section 1903(g)(3)(B), as enacted by P.L. 95-142, provided that the Secretary "shall" waive any reduction in FMAP otherwise required because of an unsatisfactory or invalid showing for the first three calendar quarters of 1977, if the Secretary determined that the State's showing with respect to the quarter ending December 31, 1977, was satisfactory and valid. Section 964 of P.L. 96-499 amended Section 1903(g)(3)(B) so that a State qualifies for a waiver of reductions for violations in any of the four quarters of 1977 if the State made a satisfactory and valid showing for any calendar quarter ending "on or before December 31, 1978."

The record shows that the Agency notified the State, by mailgram dated October 18, 1977, and Action Transmittal HCFA-AT-77-106, dated November 11, 1977, of the enactment of P.L. 95-142, which required certain changes in the Agency's policies and provided the authority for certain express waivers of the penalty.

The Agency had developed specific procedures for the States to follow when making their quarterly showings. These procedures became effective April 1, 1976. The States were notified of the procedures and subsequent modifications of the procedures by means of Action

1/ The applicable regulation was 45 CFR 250.23 until September 30, 1977, at which time it was redesignated as 42 CFR 450.23.

Transmittals (SRS-AT-76-88, June 3, 1976; SRS-AT-76-155, October 1, 1976; HCFA-AT-77-91, September 29, 1977; HCFA-AT-77-106, November 11, 1977).

Each quarter a State must submit certifications signed by the director of the State Medicaid Agency, stipulating that for each level of care there were methods and procedures in effect to assure that utilization control requirements were met. In addition to such certifications, lists are to be submitted of all MHs, SNFs, and ICFs participating in Medicaid for that quarter; these lists indicate for each facility the dates that required reviews were performed. If these certifications and lists show no violations on their face, then the Agency considers that a State has made a "facially-satisfactory" showing. These showings, however, merely state that reviews were performed on a certain date and that a physician headed each MR team. Thus, the Agency can determine from the quarterly showings whether a review was omitted or untimely, and whether a physician was on each MR team, but not whether other requirements for annual reviews were met.

Action Transmittal SRS-AT-76-88, June 3, 1976, also notified the States of the approach the Agency would use in evaluating the information submitted in the quarterly showings. The Action Transmittal explained, at page 3:

> In determining whether State showings with respect to the MR and IPR requirements are satisfactory, SRS will wait until the attached quarterly showing format has been in effect for four quarters. At the end of that period, SRS will evaluate each State's showings for these four quarters to determine whether each SNF, MH, and ICF which was a certified provider for the entire four quarters received the required inspection.

The Action Transmittal also specifically explained how often the "annual" reviews must be performed.

The Secretary is required to conduct "timely sample onsite surveys" as part of his validation procedures (Section 1903(g)(2)). The Agency has implemented this requirement by periodically conducting surveys to validate the quarterly showings, i.e., to determine whether the reviews met the Agency's requirements. The onsite surveys involve inspection of the records kept at the facilities, and generally are only performed at a selected number of the facilities, rather than all of them. The Agency alternates onsite surveys with other surveys conducted at the State agency, where the federal reviewers examine the reports filed by the MR and IPR teams. If a State cannot provide acceptable evidence of actual adequate performance of the reviews, the Agency will find the showing unsatisfactory and invalid.

The Agency found twenty States, including the State of Colorado, in violation of the annual review requirement, when the Agency reviewed the quarterly showings for the period ending March 31, 1977. P.L. 95-59, referred to above, postponed any penalties required to be taken for these violations in quarters prior to October 1, 1977. The Agency sent a letter to State Agency directors on June 24, 1977 (Exhibit 4, Agency Response to Order to Show Cause). That letter informed the States of the postponement but warned the States that they were still responsible for meeting the annual review requirements. That letter stated, at page 2:

> I would like to reiterate that all facilities whose annual review falls due during the quarter ending June 30, 1977, must be reviewed by the close of that quarter. Otherwise your State will be out of adherence with section 1903(g). Facilities which were to be reviewed by the quarter ending March 31, 1977, and which were not reviewed, must be reviewed by the quarter ending March 31, 1978, otherwise your State will be out of adherence with section 1903(g).

These instructions referred only to late or omitted reviews which had been identified in quarterly showings because the Agency had not yet conducted a validation survey (Agency Response to Order to Show Cause, page 16). The instructions were later revoked by the Agency in its Action Transmittal explaining the effect of P.L. 95-142. HCFA-AT-77-106 informed the States that, although they had previously been told that they would not be subject to a reduction until March 31, 1978 for failure to review those facilities not reviewed during the quarter ending March 31, 1977, Section 1903(g) as amended produced a change in that policy (page 3). In order to make a satisfactory showing for the quarter ending December 31, 1977, "the State must 'make up' each review omitted in prior quarters of calendar year 1977 AND must complete each review due in the current quarter ...." These instructions referred only to the reviews cited in the earlier notices of disallowance and the instructions sent out in the June 24, 1977 letter.

During the calendar year 1977 the State received three separate notices of disallowance, each regarding a quarter of 1977. Each notice based the disallowance only on the quarterly showing submitted by the State. As a consequence, these notices referred only to the types of errors detectable on quarterly showings, that is, those reviews which had not been performed or had been performed in an untimely manner. The Agency informed the State, in a letter dated December 6, 1977, that because P.L. 95-142 postponed reductions for 1977 until after December 31, 1977, the Agency was withdrawing the previous notifications of reductions for the first three quarters of

1977. The Agency informed the State in that letter, however, that it could still be subject to a disallowance based on the showings for those quarters if the State did not make a satisfactory and valid showing for the fourth quarter of 1977.

The notice of disallowance appealed here, dated January 22, 1979, stated that the State's showing for the quarter ending December 31, 1977, was facially-satisfactory because it listed a 1977 review date for every facility required to be reviewed. The notice stated, however, that the Agency was unable to validate the showing with regard to reviews performed prior to October 1, 1977 (see n. 7). The notice stated that, as a result, the State's showings were invalid for each calendar 1977 and 1978 quarter with regard to any facility in which the last review was conducted prior to October 1, 1977.

The figures provided by the Agency in its notice of disallowance show, for each level of care, the number of facilities for which the annual review requirements were not fully met and the total number of facilities to which the requirements were applicable.

	Qtr ending Dec. 31, 1977	Qtr ending March 31, 1978	Qtr ending June 30, 1978
(MH)	1 of 2	1 of 2	1 of 2
(SNF)	119 of 140	64 of 143	28 of 139
(ICF)	108 of 129	62 of 129	31 of 129

Summary of the Issues

The primary bases on which the State challenged the original disallowance were the Agency's interpretation of the statutory waiver provision, Section 1903(g)(3)(B), and the State's assertion that the Agency gave the State inadequate notice concerning what the State must do in the fourth quarter of 1977 to qualify for the waiver.

The State alleged that all it had to do in the fourth quarter of 1977 was show that a review was performed in that quarter for each facility whose review was due that quarter, and that a review was performed for those facilities which had not been reviewed in the earlier quarters of 1977. The State alleged that the waiver did not require that all of those reviews performed in 1977 which did not meet the Agency's requirements be reperformed in the fourth quarter, and that the Agency misled the State about what it was required to do in the fourth quarter. Thus, the State appeared to allege that if the reviews actually performed in the fourth quarter of 1977 under the above premise met the Agency's requirements, it did not matter whether other reviews performed in 1977 did, so long as some kind of review had been performed. This allegation, taken to its logical conclusion, implies that the result of meeting the waiver provision, as it was interpreted by the State, was not merely to waive the penalty otherwise required

to be taken for the quarters of 1977, but also to transform the inadequate reviews performed in 1977 into adequate ones. In other words, reviews performed in the first three quarters of 1977 which did not meet the Federal requirements for adequate reviews, should be considered as having satisfied the requirements, and, thus the State should be relieved of responsibility for reperforming those reviews in a satisfactory manner until the next anniversary for the reviews of those facilities. The State alleged that the States should be allowed to "start anew" (Response to Order to Show Cause, page 4).

The Agency's supplemental memorandum of March 2, 1981 informed the Board of the Agency's interpretation of the waiver provision as amended by P.L. 96-499, and stated that because the State made satisfactory and valid showings with respect to the quarters ending September 30 and December 31, 1978, the State qualified for a waiver of the reductions for all 1977 quarters (page 5). The Agency stated that reductions for the quarters ending March 31 and June 30, 1978 are still required, because the State failed to make satisfactory and valid showings for those two quarters and the waiver provision does not apply to those two quarters. The State, in its Amendment of Appeal (April 6, 1981, page 4), alleged that by amending Section 1903(g)(3)(B) in December 1980, Congress intended to remove total liability from the State and that no reductions should be taken for the quarters ending March 31 and June 30, 1978. Although the disallowance for the four quarters of 1977 is no longer at issue, the State has retained all of its arguments and allegations relating to the quarter ending December 31, 1977, particularly the issue of whether the State must have shown in that quarter that every review performed in 1977 met the Agency's requirements. The Agency's response to the Board's Order to Show Cause, however, outlined more fully the basis for the Agency's disallowance in the first two quarters of 1978. The Agency stated that the waiver did not affect the 1978 quarters and that the basis for the disallowance taken for the 1978 quarters was independent of the December 1977 disallowance. We believe that the issues should be stated in the following manner 2/:

A. The extent of the waiver for reductions, as provided in Section 1903(g)(3)(B), as amended in 1980, and the effect of the waiver on the annual review requirement.

2/ The Board's Order to Show Cause, issued July 9, 1981, discussed most of the issues related to the reductions for the 1977 quarters and the interpretation of the waiver provision with relation to the fourth quarter of 1977 on the theory that these were crucial to the basis for the disallowance taken for the first two quarters of 1978. Thus, the statement of the issues in the Order to Show Cause differs somewhat from that presented here.

B. Whether the State's showings for the first two quarters of 1978 were unsatisfactory and invalid.

(1) The basis of the Agency's finding that the showings were unsatisfactory and invalid.
(a) The meaning of satisfactory and valid under the statute.
(b) Whether a validation survey is a condition precedent to a disallowance.
(c) The meaning of the annual review requirement.

(2) Applicability of the waiver provision in Section 1903(g)(4)(B).

C. Adequacy of the Agency notice to the State about how the annual review requirement is met and how a satisfactory and valid showing is made.

D. Adequacy of Agency notice of the disallowances for the first two quarters of 1978.

E. Calculation of the penalty.

F. Other issues raised by the State.

Discussion

A. The extent of the waiver under Section 1903(g)(3)(B), as amended in 1980, and the effect of the waiver on the annual review requirement.

Section 1903(g)(3)(B), as amended by P.L. 96-499, states:

> The Secretary shall waive application of any reduction in the Federal medical assistance percentage of a State otherwise required to be imposed under paragraph (1) because a showing by the State, made under such paragraph with respect to a calendar quarter after January 1, 1977, and before January 1, 1978, is determined to be either unsatisfactory under such paragraph or invalid under paragraph (2), if the Secretary determines that the State's showing made under paragraph (1) with respect to any calendar quarter ending on or before December 31, 1978, is satisfactory under such paragraph and is valid under paragraph (2).

The plain language of this provision indicates that it does not apply to reductions for quarters after January 1, 1978; 3/ nonetheless, the State argued that the legislative history indicates that Congress gave

3/ The legislative history of P.L. 96-499 supports this statement. See H. Rep. No. 96-589, Part II, April 23, 1980, pages 85 and 132.

the Agency discretion to waive the penalty for the 1978 quarters as well. As support for this allegation, the State cited several portions of the legislative history; one paragraph the State quoted spoke of the Secretary's discretion regarding the amount of the penalty to be waived. However, reading the statement in context, 4/ it seems to refer to whether the Secretary may waive less than the full reduction. It certainly makes no reference to a discretion to waive penalties for quarters other than those specifically referred to in the statutory provision.

The State also quoted the language, "a standard of reasonableness," from a paragraph discussing Section 1903(g)(4)(B) 5/ (H. Rep. No. 95-393, Part II, 1977, page 85), arguing that it was an indication of a general standard of discretion available to the Secretary. That paragraph, however, says that the "standard of reasonableness" is the standard provided in Section 1903(g)(4)(B) and that it is provided by Congress for instances where a State failed to review two or three homes out of hundreds. The paragraph does not refer to a general discretion on the part of the Secretary to waive penalties.

This Board has previously held that Section 1903(g) does not provide the Secretary with the discretion to waive penalties, with the exception of the two specific provisions, Sections 1903(g)(3)(B) and (4)(B). (Tennessee Department of Social Services and Colorado Department of Social Services, Decisions No. 167 and 169, April 30, 1981.) Furthermore, the Comptroller General has previously reached the same conclusion (Comptroller General's Opinion, #B-164031(3).154, March 4, 1980). The legislative history supports this conclusion. The history tells us that the Agency had not been enforcing Section 1903(g) to Congress' satisfaction. At Congress' urging, the Agency

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4/ "The committee has left to the Secretary's discretion the amount of the decrease which may be waived. It fully expects that where previous violations of the law have been of sufficient magnitude, the Secretary may impose a portion of the penalty. In cases where the State is not able to show a satisfactory program that is validated by the Secretary, the committee expects that all previous reductions will be taken." (H. Rep. No. 95-393, Part III, July 12, 1977, page 85.)

5/ Section 1903(g)(4)(B) contains a waiver of any penalty required to be taken for violations of the annual review requirement in Section 1903(g)(1)(D), where a State has not reviewed a small number of facilities and meets certain other conditions. We will discuss in Section B whether the State met the standard provided in Section 1903(g)(4)(B).

began to enforce the statute strictly, with the result that twenty States received notices of large disallowances. Congress postponed these while it considered further legislation; it was concerned about penalizing the States without allowing them additional time to bring their procedures into compliance. Thus, Congress enacted P.L. 95-142, which sought to modify the immediate harsh effects of the Congressional mandate for enforcement of the utilization control requirements. The amendments set guidelines for the period in which the Agency must notify the States of disallowances, provided for an unconditional waiver of earlier penalties and a conditional waiver designed to provide the States with additional time to comply (Section 1903(g)(3)(B)), set a specific standard of tolerance for the annual review requirement, and modified the penalty to more accurately reflect the number of violations. Thus, we conclude that the statute does not authorize the Secretary to waive penalties except under the specific conditions set forth in the statute.

As discussed above, the State's allegations imply that the result of the waiver provision was not only to waive the 1977 reductions, but also to transform reviews conducted by the State prior to October 1, 1977 into adequate and timely annual reviews for purposes of meeting the annual review requirements in 1978. We refer again to the plain language of Section 1903(g)(3)(B). It specifically applies to waiver of "reductions." It does not refer to any other consequences, and the legislative history refers to the State's full compliance after December 1977.

The 1980 amendment of Section 1903(g)(3)(B) allowed the States until the end of 1978 to comply with the Section's requirements in order to qualify for waiver of the 1977 penalties; however, this created the possibility that there would be 1978 quarters during which the States might not have yet effected compliance and for which they would be subject to penalties. We recognize that a conclusion that the waiver provision does not apply to such 1978 quarters may seem inconsistent with affording the States until the end of 1978 to qualify for the waiver. The original waiver provision could not have produced this result because it required the States to fully comply immediately after the quarters to which the waiver would apply. The legislative history of the 1980 amendment did not address these problems. Instead, it contains the identical language used in the legislative history for the enactment of the original waiver provision, and, in addition, contains language which clearly refers only to the waiver of reductions in 1977. 6/ In view of the plain language in the 1980 amendment,

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6/ In fact, the legislative history specifically referred to the amount of the waived reduction for Colorado, i.e., $8 million. This figure corresponds to the penalty amount for only 1977 quarters. (H. Rep. No. 96-589, Part II, April 23, 1980, page 85.)

and the legislative history of the waiver and amendment, we have no option but to conclude that Section 1903(g)(3)(B) refers only to a waiver of the reductions for the four quarters of 1977. We reiterate our previous conclusion that the Secretary does not have the discretion to generally waive penalties under the statute. Furthermore, we conclude that the waiver of the reductions does not affect the validity of the reviews conducted prior to October 1, 1977, and therefore, does not affect the State's showings in the 1978 quarters.

B. Whether the State's showings for the first two quarters of 1978 were unsatisfactory and invalid.

(1) The basis of the Agency's finding that the showings were unsatisfactory and invalid.

(a) The meaning of satisfactory and valid under the statute.

The Agency, in the validation survey conducted for the quarter ending December 31, 1977, learned that the reviews conducted by the State prior to October 1, 1977 did not meet Federal requirements for annual reviews. Consequently, the Agency considered any reviews listed in the State's showings for 1978 quarters which had been performed prior to October 1, 1977 as violations of Section 1903(g)(1)(D) because the showings indicated that the State had not conducted a review meeting Federal requirements in the previous four quarters ending on the last day of the quarter for which the showing was made (Agency Response to Order to Show Cause, pages 3 and 4). In the Background, we discussed the fact that the quarterly showings submitted by States do not provide any indication that the annual review requirements, other than the ones referring to timeliness and composition of the MR team, were met. The purpose of the Secretary's validation is to "assure actual -- rather than paper --compliance with the ... statutory requirements." (S. Rep. No. 92-1230, September 26, 1972, page 45). Therefore, a showing indicating that timely reviews were performed in all facilities may later be found unsatisfactory and invalid because a validation survey showed that other annual review requirements were not met. The standards for annual reviews (as set forth at 42 CFR 450.23 and in Action Transmittals) are the same for "satisfactory" and "valid" showings; practically speaking, however, the Agency cannot verify whether certain standards are met on the basis of the quarterly showings alone. A State must meet the requirements; if it does not, the State must bear the consequences if the Agency undertakes a validation survey which discloses any violation.

(b) Whether a validation survey is a condition precedent to a disallowance.

The State asserted that "sample onsite surveys" (the language used in Section 1903(g)(2)) are a condition precedent to imposition of a reduction, and further, that such surveys were not performed in the State prior to taking the disallowance.

Section 1903(g)(1) states, in part, that the FMAP "shall be decreased ... unless the State ... makes a showing satisfactory to the Secretary ...." Section 1903(g)(2) provides that the Secretary "shall, as part of his validation procedures under this subsection, conduct timely sample onsite surveys of private and public institutions ...." There is nothing in the statute that requires the Secretary to validate every showing, nor does the statute specify what procedures the Secretary should use for validation other than the "sample onsite surveys." Section 1903(g)(2) does not require that such surveys be conducted every quarter. Therefore, we conclude that the validation procedures, whether sample onsite surveys or any other method, are not a condition precedent to imposition of a penalty, and that the Secretary has considerable discretion with regard to how and whether to perform a validation.

The State's allegations imply that when checking the State's compliance with Federal requirements during 1978 quarters, the Agency should have ignored the fact that reviews conducted prior to October 1, 1977 were faulty. Furthermore, the State alleged that the Agency could not base disallowances on problems existing prior to October, 1977 because Congressional intent "was to allow the states to start anew and to be evaluated on a current basis" (State's Response to Order to Show Cause, page 4). The Agency varies the type of validation surveys it performs (see Background). If a State makes a quarterly showing that is satisfactory on its face and either a validation survey does not disclose violations or a validation survey is not performed, then the State will not be subject to a penalty. This does not excuse the State, however, from responsibly meeting the utilization control requirements in the quarters not affected by the waiver provision. This Board has previously held that where the Agency finds violations (whether it discovers them on the basis of the quarterly showing or a validation survey), it has no discretion to waive the consequent penalty (supra). Here the Agency conducted a validation survey for the quarter ending December 31, 1977 and a validation survey for the quarter ending June 30, 1978. These surveys disclosed that reviews performed by the State prior to October 1, 1977 did not meet Federal standards. The State's quarterly showings for 1978 showed that, for many facilities, no reviews had been performed after October 1, 1977. Therefore, the Agency could appropriately apply the knowledge about the inadequacy of the pre-October 1, 1977 reviews in evaluating the quarterly showings submitted for the quarters ending March 31, and June 30, 1978.

(c) The meaning of the annual review requirement.

The key question is whether the State met the requirements of Section 1903(g)(1)(D), 42 CFR 450.23, and applicable Action Transmittals during the quarters ending March 31, and June 30, 1978. There are two aspects to the annual review requirements: the adequacy of the reviews,

as described by 42 CFR 450.23 and the Action Transmittals, and timeliness. The record shows that the Agency had previously determined that the State's reporting procedures for annual reviews did not provide information about individual patients and that the Federal reviewers had learned that inspection of patients' records was done on a sample basis only. The State agreed with these findings. 7/ The validation survey performed by the Agency for the fourth quarter of 1977 showed that the State had not changed its methods prior to October 1, 1977. The State has not denied that reviews performed prior to October 1, 1977 did not meet all of the requirements set out at 42 CFR 450.23.

In addition to meeting the substantive requirements of Section 450.23, annual reviews must be timely (see South Carolina Department of Social Services, Decision No. 177, May 27, 1981). The statutory and regulatory provisions require that these reviews be made "annually." The Agency first set out its interpretation of "annual" in Action Transmittal SRS-AT-76-79, May 14, 1976. This indicated that a review must be performed every 12 months. Action Transmittal SRS-AT-76-88, June 3, 1976 confirmed and clarified this policy; Action Transmittal SRS-AT-76-176, December 8, 1976, indicated that the actual due date for a review would be the last day of the anniversary month, rather than 12 months to the exact date of the last review. Finally, Action Transmittal HCFA-AT-77-106, November 11, 1977, announced that the 1977 amendments to Section 1903(g) required a change in the definition of "annual." The standard was relaxed so that "effective with quarters

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7/ On September 24, 1976, the Regional Commissioner of the constituent agency then responsible for Title XIX programs (Social and Rehabilitation Service) wrote to the State concerning a utilization control validation survey being conducted for FY '75. That survey focused on the annual medical review requirement of Section 1903(g)(1)(D) and 45 CFR 250.23 (see n. 1). The letter summarized the statutory, regulatory, and other policy requirements to which the State was subject, and stated that the Regional Office reviewers had found that the State's procedures did not comply with the requirements involving review of individual patients. The Commissioner requested further documentation regarding the medical reviews that might enable the Agency to validate the reviews, and for a complete description of the State's utilization control procedures. The letter concluded by warning the State that a "substantial penalty" might be assessed if validation was not possible.

The Executive Director of the State's Department of Social Services responded on October 7, 1976. In that letter he agreed with the Agency's assessment of the shortcomings of the State's documentation process (page 5), and indicated that the State was taking steps to reform that process (page 6). The letter showed that the State officials understood why and where their system failed to comply with Federal requirements.

beginning on or after January 1, 1977, a MR or IPR will be timely if it is conducted by the end of the anniversary quarter of the facility's entry into the program or of the last prior review" (pages 3-4). 8/

When the Agency performed the validation survey for the quarter ending December 31, 1977, it determined that it could not accept the reviews performed by the State prior to October 1, 1977 because the reviews did not meet the Agency's requirements. If the State's showings for the first two quarters of 1978 indicated that the last review made for a facility was prior to October 1, 1977, the Agency found that the State had not met the timeliness requirement because no review meeting Federal standards had been performed within the last four quarters.

The Agency's basis for its 1978 findings is that, in each of the two quarters, the Agency could not find that the State had performed adequate reviews for certain facilities within the previous four quarters, and, therefore, the Agency determined that the annual review requirements were not met (Response to Order to Show Cause, pages 21, 23). We find this analysis consistent with Agency regulations and interpretations and conclude that the State did not meet the requirements for an annual review in certain of its facilities during the first two quarters of 1978 and, therefore, its showings for those quarters were unsatisfactory and invalid.

(2) Applicability of the waiver provision in Section 1903(g)(4)(B).

The State alleged (Response to Order to Show Cause, page 2) that the statute "requires only an effective program of review; it does not mandate a perfect program of medical review." We agree that the statute does not require a perfect program because the 1977 amendments added Section 1903(g)(4)(B), which sets a "standard of reasonableness" (see previous discussion). To make a showing of an effective program, however, a State must be able to meet at least the standard set forth in that provision.

Section 1903(g)(4)(B) provides:

> The Secretary shall find a showing of a State ... to be satisfactory ... with respect to the requirement

8/ The Agency's basis for this interpretation was the language of Section 1903(g)(4)(B), which says,

> ... if the showing demonstrates that the State has conducted an onsite inspection during the 12-month period ending on the last date of the calendar quarter ....

> that the State conduct annual onsite inspections in mental hospitals, skilled nursing facilities, and intermediate care facilities under paragraph (26) and (31) of section 1902(a), if the showing demonstrates that the State has conducted such an onsite inspection during the 12-month period ending on the last date of the calendar quarter --
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> (i) in each of not less than 98 per centum of the number of such hospitals and facilities requiring such inspection, and
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> (ii) in every such hospital or facility which has 200 or more beds,
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> and that, with respect to such hospitals and facilities not inspected within such period, the State has exercised good faith and due diligence in attempting to conduct such inspection, or if the State demonstrates to the satisfaction of the Secretary that it would have made such a showing but for failings of a technical nature only.

In order to qualify for the waiver on the basis of good faith, the State must have met the review requirements in 98 percent of the facilities in the State, including all facilities containing 2 or more Medicaid beds. The record shows (Notice of Disallowance) that, for each of the two quarters in 1978 involved in this disallowance: 50% of the MHs were not reviewed; 44% and 20% respectively of the SNFs were not reviewed; and, 48% and 25% respectively of the ICFs were not reviewed.

Previous decisions of this Board have interpreted Section 1903(g)(4)(B) so that a State need not meet the 98%, 200-bed requirement in order to be excused for a technical failing (Ohio Department of Public Welfare, Decision No. 66, October 10, 1979; Utah Department of Health, Decision No. 168, April 30, 1981; South Carolina Department of Social Service, Decision No. 177, May 17, 1981).

The statute does not provide a precise definition of technical failings, but the legislative history stated that technical noncompliance would include instances where a State reviewed patients in most facilities on time with the remaining facilities reviewed "several weeks after the deadline for completion of all reviews." (S. Rep. 95-453, September 26, 1977, page 41). We do not find the State's actions with regard to the annual reviews within the description of technical failings provided by that report or technical in any sense that the word might ordinarily be used. Therefore, we conclude that neither the good faith nor technical failings exception of Section

1903(g)(4)(B) applies to the circumstances of this appeal, and that the State did not make an "effective" showing.

C. Adequacy of the Agency notice to the State about how the annual review requirement is met and how a satisfactory and valid showing is made.

As noted above, the notice issue originally turned on whether the State received adequate notice from the Agency about what the State must do to qualify for the waiver provided in Section 1903(g)(3)(B). This is no longer the issue since the State qualified for the waiver under the provision as amended. The State, in its Response to the Order to Show Cause (page 4), argued that Congress had concluded that the Agency's notice to the State about its review system was inadequate and "that HEW should be estopped from imposing further penalties if the states showed that they were making progress in correcting alleged deficiencies."

There is nothing in the legislative history which can be construed as a belief on Congress' part that the States had received inadequate notice about whether their annual review systems complied with requirements. Congress was concerned about the adequacy of notice to the States that there would be stricter enforcement of the utilization control requirements, including that of annual reviews, and wanted to ensure that the States would understand that they could no longer retain systems which violated Section 1903(g). There seems to be little doubt that the State had adequate notice of and, in fact, understood what it must do to comply with Federal requirements for annual reviews (see n. 7 and discussion in Section A regarding the interpretation of "annual"). Furthermore, the legislative history does not indicate that the States should not be penalized "if they were making progress." The legislative history does say, "Section 20 provides an additional 6-month period to States to meet the requirements" and "[t]he committee has approved an amendment which would give States an additional 6 months to demonstrate full compliance with the law." (H. Rep. No. 95-393, Part II, July 12, 1977, pages 83 and 85). The history of the waiver provision's most recent amendment includes the statement, "[the committee] fully expects and intends that Colorado and all other States participating in medicaid will take the necessary steps to remain in full compliance." (H. Rep. No. 96-589. Part II, April 23, 1980, page 85.)

The State had clear notice of what was expected for compliance with the annual review requirements. A review must be conducted within four quarters after the quarter in which the last prior review was conducted, and the reviews must meet Federal requirements. Whether the Agency elected to try to validate the State's performance is irrelevant to whether the State was required to meet the standards each quarter. The State has not pointed to any language in the

statute, regulations, or any other communication from the Agency, which might have indicated that the State was relieved by the waiver from meeting the annual review requirements in those quarters. Furthermore, HCFA-AT-77-106 stated, at page 8:

> In order to enable the Department to judge the satisfactoriness of States' showings under the statute as amended, the requirements for quarterly showing submissions are hereby modified .... Effective with the showing ending December 31, 1977, States are to include ... a list of all facilities ... which did not receive an appropriate review during the 12-month period ending on the last date of the showing quarter ... and should state the reasons, if any, why the facility did not receive a timely and/or appropriate review.

We conclude that the State received adequate notice of what it must do in the 1978 quarters to meet the annual review requirements. Therefore, there is no need to consider whether the Agency was estopped from imposing the disallowance. Even if we were to consider the question, the State has not pointed to any statements which could reasonably have misled the State with regard to 1978 quarters nor has the State offered any proof that the Stated relied on such statements to its detriment. Hampton v. Paramount Pictures Corp., 279 F.2d 100, 104 (9th Cir. 1960); U.S. v. Georgia Pacific Co., 421 F.2d 92, 96 (9th Cir. 1970); Choat v. Rome Industries, Inc., 462 F. Supp. 728,730 (N.D. Ga. 1978).

D. Adequacy of Agency notice of disallowance for the first two quarters of 1978.

Section 1903(g)(3)(A)(iv) provides that notice of a reduction must be "provided to the State no later than the first day of the fourth calendar quarter following the calendar quarter with respect to which such showing was made." The Agency provided the State with a brief notice of the disallowance on December 29, 1978, which was timely under the above provision. That notice informed the State that it would receive a more detailed official notice later.

The State received a second notice, dated January 22, 1979, which set forth the reasons for the disallowance in great detail. The State, in its Application for Review, asserted that neither notice met both the requirements of Section 1903(g) and 45 CFR 16.91.

There is no requirement that one document meet the purposes and requirements of both provisions. The purpose of the statutory provision, which is to ensure that the State not be subjected to uncertainty as to whether a reduction will be imposed (H. Rep. No. 95-393, Part II,

July 12, 1977, page 85, and S. Rep. No. 05-453, September 26, 1977, page 41), was met by the first notice. The second notice was the one which triggered the running of the time period for appeal to the Board. The purpose of 45 CFR 16.91, which is to enable the grantee to respond to a disallowance, was met by the second notice, which was very complete. No interests of the State have been prejudiced. We therefore conclude that the State received adequate notice of the disallowance.

E. Computation of the Penalty

The State raised two issues with regard to the computation of the penalty. (1) The Agency improperly used facilities rather than the number of patients for computation of the penalty. (2) The "60- and 90-day exemptions" have not been accounted for in the computation.

(1) Section 1903(g)(5) provides the formula for computation of the penalty. It states:

> [T]he percentum amount of the reduction of the State's Federal medical assistance percentage for that type of services under paragraph (1) is equal to 33 1/3 per centum multiplied by a fraction, the denominator of which is equal to the total number of patients receiving that type of services in that quarter under the State plan in facilities or institutions for which a showing was required to be made under this subsection, and the numerator of which is equal to the number of such patients receiving such type of services in that quarter in those facilities or institutions for which a satisfactory and valid showing was not made for that calendar quarter.

The Agency has a policy, clearly stated in the attachment to any notice of disallowance issued under Section 1903(g), that where it does not have exact patient data, it estimates the penalty based on the number of facilities out of compliance. The State may supply exact recipient data, and if the Agency believes that it is accurate, it will use the data to recalculate the penalty. This Board has previously held that such a policy is reasonable, given the difficulty the Agency would have acquiring exact data unless the State, which keeps the records, supplies the data (Ohio Department of Public Welfare, Decisions No. 66, October 10, 1979, page 14, and No. 191, June 24, 1981, page 7).

The State asserted (Response to Order to Show Cause, page 5) that it cannot supply these figures because a validation survey must determine the number of patients who should comprise the numerator and the State is unaware of whether the facilities' records have been validated. We

have already concluded that a validation survey is not a necessary precedent to a disallowance. Furthermore, the notice of disallowance clearly indicated which facilities should be included in the numerator, so that the State should have known what to supply for those facilities. The State argued that the Agency should provide the data because the burden of proof is on the party seeking to impose the penalty. The Agency has already proved that the penalty should be imposed. The issue is only how the penalty is calculated, and the party with access to the data is the State. If the State is unwilling or unable to provide exact patient data, the Agency is justified in using facility data.

The State also argued that the use of facility data "can seriously distort the outcome" (page 5). It provides an example which it admits is "extreme" (page 5). Although we recognize that the use of facility data in the penalty may result in a different penalty amount than the use of exact patient data, we do find the State's example exaggerated. It assumes that 50% of the facilities have one-quarter of the State's patients and the other 50% have three-quarters of the patients; then it assumes that the 50% of the facilities with the bulk of the patients was the 50% in which no violations were found. This is unrealistic. In the quarter ending March 31, 1978, nearly 50% of all facilities in the State had not been reviewed in a timely and adequate manner. Because of the nature of the State's violations, it can be assumed that all patients in those facilities were unreviewed in an adequate and timely manner; therefore, using a more realistic assumption that 50% of the State's patients resided in 50% of its facilities, the figures would be very close, no matter which type of data was used. For the quarter ending June 30, 1978, the same proposition would be true for MH level of care. For the other two levels of care, although we cannot automatically assume that one-fifth or one-quarter of the State's patients resided in one-fifth or one-quarter of the State's facilities, we can assume that it was considerably more proportionate than in the State's example. The Agency indicated at the time the disallowance was taken, and reiterated the point in its Response to the Application for Review (page 36), that it would recalculate the penalty if the State supplied exact patient data. The State has never supplied this data. We conclude that the Agency's use of facility data under these circumstances is reasonable.

(2) The State apparently uses the terminology "60- and 90-day exemptions" to refer to the language in the first paragraph of Section 1903(g) which makes the requirements applicable only to those patients residing in facilities for periods longer than 60 or 90 days, depending on the level of care, and which makes reductions only in the FMAP furnished after those periods. The Agency explained, in its Response to the Application for Review (pages 34-35), that in the absence of exact data on the length of stay for each patient in the State, it estimates the exemption by automatically excluding from the penalty

calculation the first 60 and 90 days of services for which expenditures are claimed in any fiscal year. The penalty calculations show that this was done. The State has not provided more accurate data, nor has it provided an alternative method of figuring the exemption. Considering the difficult task of calculation for each patient, we believe the Agency has acted reasonably. There is no basis in the record for upholding the State's mere allegations.

F. Other issues raised by the State.

The State originally raised two other issues: (1) the constitutionality of the penalty provision, and (2) the lack of uniform treatment by the Agency of similarly situated States. We indicated in our Order to Show Cause that we would not address the issue of constitutionality of the penalty provision since 45 CFR 16.8(a) binds this Board to applicable laws and regulations. The State did not provide any evidence for its second allegation, either in the Application for Review or in its Response to the Order to Show Cause; the Agency (Response to Application for Review, pages 36-37) pointed out that the other states qualified for the waiver, despite having similar burdens placed upon them and receiving the same notice as this State. Therefore, we conclude that there is no basis in the record for revising the disallowance because of this allegation.

Conclusion

We conclude that the reduced disallowance in the amount of $2,881,309 should be upheld for the reasons discussed above.

/s/ Donald F. Garrett

/s/ Norval D. (John) Settle

/s/ Cecilia Sparks Ford, Panel Chair