DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: New York Department of Social Services
Docket No. 85-94
Audit Control No. 02-50253
Decision No. 788

DATE: September 19, 1986

DECISION

The New York State Department of Social Services (State) appealed a determination by the Health Care Financing Administration (Agency or HCFA) to disallow $957,969 in federal financial participation (FFP) claimed by the State for the development and implementation of the State's Welfare Management System (WMS) for the period October 1, 1977 through March 31, 1982. 1/ The State appealed only $748,810 disallowed for costs allegedly claimed at improper FFP rates. The Agency later withdrew its disallowance of $341,310 FFP, reducing the amount in dispute to $407,500 FFP.

The remaining amount in dispute relates to site preparation costs and training costs which the Agency alleged were claimed at the improper rate of FFP. For the reasons stated below, we uphold the Agency's disallowance.

1/ With its notice of appeal, the State provided copies of two disallowance determinations. The first, by the Acting Deputy Assistant Secretary for Management Analysis and Systems, discusses audit findings from ACN 02-50253. The determination letter noted that two categories of costs remained in dispute: $748,810 in costs claimed at improper FFP rates from HCFA and $199,904 in nonpersonal services claims by Erie County. (The disallowed amount of $199,904 was assigned Docket No. 85-95 and has been decided by the Board in Decision No. 713. That decision has no bearing on the instant matter.)

The second determination, by the HCFA Regional Administrator, duplicated in part the findings of the Deputy Assistant Secretary for Management Analysis and Systems concerning the HCFA share of the audited costs. The Board assigned Docket No. 85-94 to the appeal of the costs charged to HCFA. Consequently, our decision here disposes of both determinations on HCFA costs.

I. Site Preparation Costs ($115,855 FFP)

A. Background

Under Title XIX of the Social Security Act (Medicaid), FFP is available in the costs of a mechanized claims processing system at the rate of 90 percent for costs attributable to the design, development, or installation of the system and at the rate of 75 percent for costs attributable to the operation of the system. Section 1903(a)(3)(A) and (B).

An HHS audit found that the State improperly claimed site preparation costs associated with the WMS, a mechanized claims processing system, at the 90 percent rate of FFP, rather than the 75 percent rate of FFP specified for these costs in the State Medicaid Manual. The auditors cited section 11275.25 of the State Medicaid Manual, which states, in part:

> . . . Costs for site preparation are start-up costs for operations and will be matched at 75 percent FFP . . . .

To determine the excess FFP claimed, the auditors recalculated the amount claimed to reflect the appropriate FFP rate. HCFA disallowed the difference between the claimed amount at 90 percent and the auditors' recalculation at 75 percent.

B. State's Arguments

The State argued that site preparation costs were a necessary component of installation of a system and that, therefore, the Agency's interpretation that they were costs of operation was inconsistent with the governing statute and regulations. The State did not deny that it had timely notice of the Agency's interpretation, but argued in effect that the Agency had approved an alternative interpretation since it had approved and paid site preparation costs as part of the "developmental" costs in the State's Advance Planning Document (APD) and had approved reimbursement at 90 percent in the State's cost allocation plan (CAP).

C. Discussion

1. Whether the Agency's interpretation is consistent with the statute and regulations

The State described the site preparation costs at issue here as the costs of "modifying the situs of a computer center or remote installation to accommodate the environmental (heating and cooling), electric, and telecommunication needs of the

system hardware." State's brief, p. 8. 2/ The State argued that, under HCFA regulations, as well as general Department regulations on automatic data processing, all peripheral or auxiliary equipment used in support of electronic computers is included as an integral part of a system, and, therefore, site preparation of the type described is a necessary component of the installation of any system. The State further alleged that site preparation had to be performed prior to the installation and testing of the computer system hardware and could not be delayed until the system was ready for operation. Thus, the State concluded that HCFA's interpretation that site preparation costs are costs of operation was inconsistent with the statute and regulations.

At first look, the State's argument appears to have merit since from a layman's view the costs described by the State would appear to be costs necessarily incurred before a State could properly install a computer and its peripheral or auxiliary equipment. A closer examination of the HCFA regulations makes it clear, however, that the State's position is not based on a reasonable reading of those regulations. Agency regulations provide certain definitions intended to aid in determining whether a cost is properly attributable to design, development, or installation of a system or to operation of a system. Definitions relevant here are as follows:

> "Design" . . . means the putting together of [a] new or more efficient automatic data processing system. This includes the use of hardware to the extent necessary for the design phase.
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> "Development" means the definition of system requirements. . . . This includes the use of hardware to the extent necessary for the development phase.
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> "Hardware" means automatic equipment used for a . . . system. This equipment accepts and stores data, performs calculations and other processing steps, and produces information. Hardware includes:
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> (1) Electronic digital computers;
> (2) Peripheral or auxiliary equipment used in

2/ The Agency appeared to be alleging that the State must now provide documentation to show that the costs it claimed were in fact the type of costs described by the State as site preparation costs. We agree with the State that since the audit did not raise this as an issue, the State was not required to further document these costs in its appeal file.

support of electronic computers;
(3) Data transmission or communications equipment; and
(4) Data input equipment.

"Installation" means the integrated testing of programs and subsystems, system conversion, and turnover to operational status. This includes the use of hardware to the extent necessary for the installation phase.

"Mechanized claim processing and information retrieval system" means a system of software and hardware used to process Medicaid claims and to retrieve and produce . . . information about services. . . .

"Operation" means the automated processing of claims, payments, and reports. "Operation" includes the use of supplies, software, hardware, and personnel directly associated with the functioning of the mechanized system.

"Software" means computer programs, procedures, and associated documentation used to operate the hardware.

42 CFR 433.111 (1979). 3/

Under the regulations, the fact that a cost might be considered related to "hardware" does not mean that the cost is automatically reimbursable at the 90 percent rate. Some "hardware" costs are claimable only at the 75 percent rate for operations. Only the use of "hardware" is claimable at the 90 percent rate and then only to the extent necessary for the design, development or installation phase of a system.

Moreover, the State's argument that the site preparation costs were a necessary component of installation relied on viewing installation as the physical act of establishing a computer at a particular site and attaching all of the peripheral and auxiliary equipment. Indeed, the State's argument that the Agency's interpretation was contrary to the statute also relied solely on this meaning of the term "installation." Yet, the definition of the term "installation" in the regulations does not specifically include costs of modifying the site and limits "hardware" itself to use necessary for testing, system conversion, or turnover to operations. The State did not argue that the regulatory definition was inconsistent with the statute or its legislative history, nor did the State relate its argument to the specific definition of "installation" in the regulation.

3/ These regulations appeared in substantially the same form in 45 CFR 250.90 (1974).

Finally, as we discuss further below, the regulation does not require the result that all costs that must be incurred prior to operations are costs of design, development, or installation. The key question here is the nature of the cost, not the time when the cost is incurred. To be reimbursable at the 90 percent rate, costs must be "attributable to" design, development, or installation. Costs which are "associated with" the functioning of the system are operations costs reimbursable only at 75 percent.

The Agency's interpretation that site preparation costs are costs of operations is a longstanding one, which is reasonable. On June 10, 1974, HCFA issued Part 7 of the Medical Assistance Manual which contained instructions regarding FFP for mechanized claims processing systems. Section 7-71-50 provided clearly that:

> Costs for site preparation are start-up costs for operations, and will therefore be matched at 75% FFP.

MSA-PRG-31, 7-71-50, p. 52, Agency Exhibit (Ex.) R-2. Moreover, the regulations at 42 CFR 433.110 (1979), pertaining to the rates of FFP for costs of a mechanized claims processing system, specifically mention that the provisions of Part 7-71-00 of the Medical Assistance Manual are applicable also to these costs. Subsequently, in July 1981, the states were sent Part 11 of the State Medicaid Manual. This part replaced the Medical Assistance Manual and other Medicaid instructions. Part 11 covered mechanized claims processing systems. Section 11275.25 of the State Medicaid Manual covered site preparation costs; in fact, it contained the same provision verbatim regarding site preparation costs as appeared in MSA-PRG-31 in 1974. See Agency Ex. R-3.

The State did not deny that it had notice of these provisions. The Board has held previously that actual notice of the Agency's policy interpretation, if reasonable, is sufficient to bind a state to its terms. See Maine Department of Human Services, Decision No. 712, December 11, 1985; New York State Department of Social Services, Decision No. 520, February 29, 1984; and Social Service Board of North Dakota, Decision No. 166, April 30, 1981.

The manual provisions are reasonable. They flow from the regulations, which limit 90 percent FFP to use of hardware to the extent necessary for design, development, or installation. The manual provisions distinguish generally between equipment or supplies purchased for operational purposes, where the intent is for continued use, and these things when purchased (or rented) solely for testing purposes. Treating site preparation costs as operations costs also makes sense since

they are the types of costs generally not charged in a lump sum but required to be depreciated or amortized over a period of time or charged through a use allowance.

Finally, we do not think that the State had a valid point when it alleged that site preparation costs should be considered part of design, development, and installation because those costs are also the costs of "start-up" of operations. Design, development, and installation costs, like site preparation costs, may be necessary to "start-up" of operations, but this does not ineluctably lead to the conclusion that site preparation costs are properly charged as part of the costs of the design, development, or installation phase.

Thus, we conclude that the Agency's interpretation in its manuals is a reasonable one, consistent with the statute and regulations.

2. Whether the Agency approved another interpretation

Having determined that the Agency's interpretation in its manuals is reasonable, we now discuss whether the Agency somehow adopted another interpretation. The State relied on the Board's decision in New Jersey Department of Human Services, Decision No. 648, November 22, 1985, arguing that that case controlled here. In Decision No. 648, the Board found that the Agency's approval and payment of certain Statewide indirect costs at an enhanced rate of FFP undercut the reasonableness of the Agency's interpretation (advanced as a basis for the disallowance) that such costs were not directly attributable to a mechanized claims processing system. The State argued that this case was analogous since the Agency had approved its planning documents and cost allocation plan and paid the 90 percent rate for site preparation costs.

The State's reliance on Decision No. 648 is misplaced. In that case, Agency issuances reasonably could be read as supporting New Jersey's interpretation that the costs at issue were subject to the enhanced FFP rate. Here, the Agency's issuances clearly and unambiguously stated that site preparation costs are reimbursable only at the 75 percent rate. Moreover, the "approval and payment" here simply do not have the same significance they had in Decision No. 648.

At the outset, we note that the mere fact that the State may have been paid for site preparation costs at the 90 percent rate of FFP is not sufficient to show approval. The record fails to show that the State made any claims for reimbursement specifically identifying site preparation costs as costs claimed at the 90 percent rate. There is no indication that

the Agency was aware or should have been aware that the State was making such claims.

Moreover, the record does not support the State's assertion that the Agency previously approved site preparation costs of the WMS at the 90 percent rate of reimbursement. The State argued that site preparation costs were contained in the Advanced Planning Document (APD) (State Exhibit 9) approved by the Agency (State Exhibit 2). These documents, however, do not indicate what the State claimed they indicate. The APD does not specifically state that site preparation costs are considered part of "development" or "installation" or that the State will claim them as such at the 90 percent rate of FFP. 4/ The only mention of site preparation is on a "Summary Schedule" (Ex. 9, p. 28), showing when the State anticipated taking certain steps in making the WMS operational; that schedule does not mention what rate of FFP will be claimed for these costs. Instead, the rate of reimbursement for the costs of designing, developing and implementing the WMS is discussed in the APD at pages 39-40. Those pages indicate that the State was seeking approval of a special FFP rate, upon which all FFP reimbursement requests for WMS from all Department programs would be based. The Agency approval of the APD, which the State contended supported a 90 percent rate of reimbursement for these costs, instead merely stated that the Agency "approve[s] the plan except for the 'composite rate' method of claiming WMS cost." The letter then states that FFP may be claimed at the appropriate rate if costs of the WMS are allocated properly. The letter further states that, until the State's cost allocation methodology is approved, approval is given for the State to claim at a rate of 50 percent for documented costs actually incurred for the WMS project from April 1, 1975. State Ex. 2, p. 1.

The record also does not support the State's contention that the Agency had approved reimbursement at 90 percent in the State's cost allocation plan for these site preparation costs. As the Board has stated previously, the purpose of a CAP is to set forth the method a state will use in distributing certain joint costs among several benefitting programs. Consequently, approval of a CAP is not approval of particular costs to be claimed. See Oregon Department of Human Resources, Decision No. 729, March 20, 1986, pp. 15-16, and cases cited therein. Costs claimed in accordance with

4/ We also note that the APD refers to "development and implementation" of WMS and does not track the terminology in the HCFA regulations. This is not surprising since WMS is a broader system, intended to serve programs other than Medicaid.

the plan still must be allowable under the applicable cost principles, regulations, and law and are still subject to any administrative or statutory limitations. Id. at 16.

In this particular case, the initial CAP approval indicated that the agreed upon methodology applied only to "design and development costs of WMS." State Ex. 3. The State provided no analysis to show the Board where in the CAP it states specifically that site preparation costs are to be considered design and development costs under the CAP. In light of the fact that the Agency had interpreted site preparation costs as operational costs since 1974 and this CAP was not approved until 1977, it would not be reasonable for the State to assume that the Agency's silence in the CAP approval on these particular costs meant that site preparation costs could be considered design and development costs. The record indicates that the Agency in 1979 explicitly told the State to convert from a developmental costing to an operational costing method because HHS did not accept the concept that WMS would remain in a developmental status until operational in all counties. State Ex. 5, Memorandum dated May 25, 1979, p. 8. This supports the Agency's argument that the key question here is the nature of the cost, not the time when the cost is incurred.

Thus, we conclude that the Agency did not approve payment of these costs at the 90 percent rate either by payment of the State claims, approval of the APD, or approval of the CAP. We therefore conclude that the Agency did not disavow its interpretation in the manual provisions. Since that interpretation is reasonable, and the State had timely notice of it, the State is bound by it. Accordingly, we uphold the disallowance of $115,855 in site preparation costs.

II. Training Costs ($291,645 FFP)

A. Background

The auditors determined that the State improperly claimed training costs associated with the WMS program at the 90 percent FFP rate rather than the 50 percent FFP rate allowed by regulation. The auditors cited the provisions of 42 CFR 432.50(3), which states, in part:

> For personnel engaged in design, development, or installation of mechanized claims processing and information retrieval systems, the rate is 50 percent for training . . . .

The auditors, therefore, recalculated the State's claim to reflect the appropriate FFP rate. The Agency disallowed the

difference between the amount claimed at 90 percent and the amount allowed by the auditors for training at 50 percent.

B. State's Arguments

The State essentially argued that the regulation cited by the auditors is inconsistent with section 1903(a)(3)(A) of the Act. The State argued that the statute allows 90 percent for all costs attributable to the design, development and installation of a system, including costs of training staff engaged in design, development, or installation of a system.

The State also argued that regulations in effect at the time of the approval of the APD (45 CFR 250.120(b) and (e)) did not limit costs of training staff engaged in design, development, or installation to 50 percent reimbursement. The State contended that the later version of the regulations, cited by the auditors, was a substantive change from the previous version, contrary to a statement in the Federal Register that no substantive change was intended. 5/

The State also argued that despite the regulation the Agency continued to reimburse the State at 90 percent FFP and to approve Supplemental Planning Documents (SPDs) and CAPs containing 90 percent FFP for such training costs.

C. Discussion

We conclude that costs of training personnel engaged in design, development, or installation of the WMS are not reimbursable at the 90 percent rate of FFP.

First, contrary to the State's assertions, as early as 1974 the Agency's regulations at 45 CFR 250.120(b) and (e) provided that FFP is not available at the rate of 90 percent FFP for

5/ The regulation providing for FFP for costs of staff involved in design, development, or installation of a system was first codified at 45 CFR 250.120 (1974). This regulation was later redesignated as 42 CFR 450.120. See 42 Fed. Reg. 52827 (September 30, 1977). The Agency later decided to bring together in one regulation all the Agency's policies on staffing and training costs applicable to the Medicaid program. Thus, 42 CFR 450.120 was deleted and 42 CFR Part 446 was amended by adding a new section 446.175(3). See 42 Fed. Reg. 60564 (November 28, 1977). It was in the preamble to the publication of 42 CFR 446.175(3) that the Agency stated that there were no substantive changes made to the current policies in 42 CFR 450.120. This regulation was later redesignated as 42 CFR 432.50(3). 43 Fed. Reg. 45199 (September 29, 1978).

the cost of training personnel engaged in the design, development, or installation of a mechanized processing system. That provision stated:

* * *

> (b) Federal financial participation at 90 percent is available for salary and other compensation, and travel costs of personnel engaged in design, development, or installation of mechanized claims processing and information retrieval systems and at 75 percent for salary and other compensation, travel and training costs of personnel engaged directly in the operations of such mechanized systems. . . .
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> (e) Federal financial participation at 50 percent is available in the costs of all other staff employed in the administration of the plan.

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45 CFR 250.120(b) and (e) (1974) (emphasis added).

The present regulation at 42 CFR 432.50(3) provides:

> (3) For personnel engaged in the design, development, or installation of mechanized claims processing and information retrieval systems, the rate is 50 percent for training and 90 percent for all other costs specified in paragraph (a) of this section.

In the earlier provision, "training" is not included as one of the costs for which reimbursement is available at 90 percent whereas "training" is specifically mentioned as a cost reimbursable at 75 percent. We find the absence of any mention in the earlier version of "training" at 90 percent significant because the regulation provides that then only 50 percent reimbursement is available. 45 CFR 250.120(e). The later version, which provides this all in one subsection, merely makes explicit what is logically implicit in the earlier version. Thus, we find no substantive change between the former version and the later version and further determine that the State was on notice or should have been on notice at the time it submitted its APD in 1976 of the Agency's regulations at 45 CFR 250.120(e) that costs of training of staff engaged in design, development, or installation of a mechanized claims processing system were reimbursable only at the 50 percent rate of FFP.

Second, the State's argument that 42 CFR 432.50(3) is inconsistent with section 1903(a)(3)(A) is flawed. The Act provides that the Secretary shall pay 90 percent FFP of the amounts expended as are attributable to design, development, and installation of a system. Training costs of personnel engaged in design, development, and installation are not necessarily included in a reference to costs attributable to design, development, and installation of a system. We find reasonable the Agency's position here that training personnel engaged in design, development or installation of the WMS would be counterproductive to the goal of encouraging states to develop a system as efficiently as possible, as provided by section 1903(a)(3)(A). It makes no logical sense to take valuable time and resources to train someone to design a system (although it is logical to train a data processor how the system works once the system is designed and installed). The Agency has shown reasonable policy considerations why these costs are not necessarily costs "attributable to" the design, development, or installation of a system. Thus, we conclude that the regulations are not inconsistent with the Act.

Finally, we cannot agree with the State that the Agency should be estopped from disallowing these costs because it allegedly reimbursed the State at 90 percent FFP and approved SPDs and CAPs containing provision for 90 percent FFP for such training costs. 6/ The record does not show that the State made any specific claims for reimbursement for such training costs at the 90 percent rate. Consequently, there is no indication that the Agency was aware that the State was making such claims when the Agency paid the State's claims. Similarly, the State has not pointed to, and we are unable to find, a provision of the CAP or the SPD which specifies that such training costs are reimbursable at 90 percent FFP. Thus, the fact that the Agency may have approved a SPD or CAP does not mean it approved these costs at the 90 percent rate. See, also, our discussion in section I.C.2., pp. 6-8, above.

The record does not support a finding of estoppel here. At the very least, the record must show that all the elements

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6/ The State also argued that Board Decision No. 648 was controlling here for the same reasons it indicated for site preparation costs. As we indicated above, we do not find that decision controlling here. See Section I.C.2, p. 6, above.

necessary to estop a private party are present. Thus, the State must establish the basic elements of equitable estoppel:

> The party asserting estoppel must show more than that he was ignorant about some matter. Among the more important requirements of estoppel are that the party to be estopped has misrepresented or wrongfully concealed some material fact and that this party acted with the intention that the asserting party rely to his detriment on this misunderstanding.

State of New Jersey v. Department of Health and Human Services, 670 F. 2d 1284, 1297 (3rd Cir. 1982), quoting from United States ex. rel. K & M Corp. v. A & M Gregos, Inc., 607 F. 2d 44, 48 (3rd Cir. 1979); see also Arkansas Department of Human Services, Decision No. 717, January 8, 1986; New Mexico Human Services Department, Decision No. 708, December 6, 1985. Here, the facts discussed above show that the traditional elements of estoppel are not present.

Even if the State had established the traditional elements of estoppel, something more is required to estop the federal government. The Supreme Court has stated that "it is well settled that the Government may not be estopped on the same terms as any other litigant." Heckler v. Community Health Services of Crawford County, 467 U.S. 51, 60 (1984). The Supreme Court has refused to decide whether even "affirmative misconduct" will suffice to estop the federal government. See Schweiker v. Hansen, 450 U.S. 785 (1981); INS v. Hibi, 414 U.S. 5, 8 (1973). What is clear is that the federal government cannot be estopped in the absence of "affirmative misconduct." The Supreme Court has never defined "affirmative misconduct," but it clearly requires something more than inaction over a long period of time. See INS v. Miranda, 459 U.S. 14, 17-18 (1982). We also have no evidence here of affirmative misconduct on the part of the Agency.

Thus, we conclude that the costs of training personnel engaged in design, development or installation a mechanized system are reimbursable only at the 50 percent rate. Accordingly, we uphold the disallowance of $291,645.

Conclusion

For the reasons stated above, we uphold the disallowance.

Cecilia Sparks Ford

Alexander G. Teitz

Judith A. Ballard
Presiding Board Member