Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Detroit Wayne Mental Health Authority
Docket No. A-14-1
Decision No. 2583
July 8, 2014

DECISION

The Division of Cost Allocation (DCA) of the federal Department of Health and Human Services (HHS) issued a determination regarding a proposed use of Medicaid funds. The Detroit-Wayne County Community Mental Health Agency, then a department of Wayne County, Michigan, had received the funds to provide mental health and related services in the fiscal year ending September 30, 2012 (FY2012). The Detroit Wayne Mental Health Authority, which assumed the assets and liabilities of the County agency effective October 1, 2013, appealed DCA's determination. We refer to the appellant and its predecessor agency as "Detroit-Wayne," except where we need to distinguish the two entities. Detroit-Wayne originally estimated it had about $16 million unexpended Medicaid funds from FY2012, but later reduced the estimate to $4.8 million. Detroit-Wayne requested approval by DCA to use those funds to pay down unfunded accrued liabilities for post-retirement benefits for Detroit-Wayne's current and retired employees. DCA denied the request. DCA concluded that use of the Medicaid funds as proposed would violate the applicable cost principles and result in the federal government bearing a disproportionate share of the costs of the benefits. DCA informed Detroit-Wayne that, as a result of its determination, the federal share of the unexpended Medicaid funds should be returned to the federal government.

For the reasons explained below, we conclude that the applicable cost principles do not permit the proposed use of the unexpended funds, and that federal law and Detroit Wayne's contract with the state Medicaid agency require return of the federal share of the Medicaid funds to the federal government.

Applicable Law

The Medicaid program under title XIX of the Social Security Act (Act) provides for grants to states to furnish medical assistance to the needy. Section 1903(d)(2)(C) of the Act requires states generally to refund the federal share of any Medicaid overpayment "made by a State to a person or entity," such as a provider of services. Applicable regulations define "overpayment" as the amount a state Medicaid agency pays "to a provider which is in excess of the amount that is allowable for services furnished under

section 1902 of the Act." 42 C.F.R. § 433.304. As we discuss below, the Medicaid funds at issue here were paid to Detroit-Wayne to provide services to eligible Medicaid beneficiaries.

The allowability of costs claimed under federal grants or subgrants by state and local governmental units, including a county, local public authority, or any agency or instrumentality of a local government, was governed during the relevant period by Office of Management and Budget (OMB) Circular A-87, then codified at 2 C.F.R. Part 225 ("Part 225"). *See* 45 C.F.R. § 92.22(b). To be allowable under federal awards, costs claimed must (among other general criteria) be "necessary and reasonable for proper and efficient performance and administration of Federal awards" and be "allocable to Federal awards under the provisions of 2 CFR part 225." Part 225, App. A, ¶¶ C.1.a, b. A cost "is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received." *Id*. at ¶¶ C.3.a, b.

A cost must also "[c]onform to any limitations or exclusions set forth in [the cost] principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items." *Id.* at ¶ C.1.d. Claimed costs must also "[b]e consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit" and "[b]e accorded consistent treatment." *Id*. at ¶¶ C.1.e, f. Among the factors to consider in determining whether a cost is reasonable are "[s]ignificant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost." *Id*. at ¶ C.2.e.

This case involves payments Detroit-Wayne seeks to make towards the costs of pensions and other post-retirement benefits. Under the cost principles, fringe benefits for employees, including pensions, are "allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit." Part 225, App. B, ¶ 8.d.(1). The cost of employer contributions for "pension plan costs … and other similar benefits are allowable, provided such benefits are granted under established written policies" and "shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities." *Id*. at ¶ 8.d.(5).

Pension plan costs may be "computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit." *Id.* at ¶ 8.e.[1] Pension costs "calculated using an actuarial cost-based method recognized by GAAP [Generally Accepted Accounting Principles] are allowable for a given fiscal year if they are funded for that year within six months after the end of that year" although "[t]he cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund." *Id.* at ¶ 8.e.(2).[2]

Post-retirement health benefits (PRHB) costs must, like pension plan costs, be computed "in accordance with established written polices of the governmental unit." *Id.* at ¶ 8.f. PRHB costs computed on a pay-as-you-go basis, as here, are "limited to those representing actual payments to retirees or their beneficiaries." *Id.* at ¶ 8.f.(1). And, as with pension costs, PRHB "calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year," a deadline that the cognizant agency may extend. *Id.* at ¶ 8.f.(2).

Case Background

A. *The Medicaid funds*

HHS has authorized the State of Michigan to provide selected Medicaid services related to mental health services, developmental disability services, and substance abuse services to Medicaid beneficiaries on a managed-care basis, pursuant to a waiver under sections 1915(b) and (c) of the Act. DCA Ex. 5, at 14; DCA Br. at 2-4. Detroit-Wayne manages the provision of those services to Medicaid recipients in Wayne County under a contract with the Michigan Department of Community Health (MDCH), the state Medicaid agency. As noted above, prior to October 1, 2013, Detroit-Wayne was the Detroit-Wayne County Community Mental Health *Agency*, a department of Wayne County. Pursuant to a Wayne County resolution of June 6, 2013, Detroit-Wayne became the Detroit Wayne Mental Health *Authority*, which is not part of the Wayne County government (although it still has some ties to the County and is a governmental unit under the cost principles). Detroit Wayne (DW) Ex. 6.

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[1] Pay-as-you-go is a "method of financing a benefit plan under which the contributions to the plan are generally made at about the same time and in about the same amount as benefit payments and expenses becoming due." DW Ex. 10, at 24.

[2] "'Cognizant agency' means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under 2 CFR part 225 on behalf of all Federal agencies." Part 225, App. A, ¶ B.6; DCA Ex. 4, at 3. OMB designated HHS as the cognizant agency for Wayne County. 51 Fed. Reg. 552 (Jan. 6, 1986).

Under the Medicaid contract for FY2012, Detroit-Wayne acted as a "Prepaid Inpatient Health Plan" (PIHP) to "provide a comprehensive array of specialty mental health and substance abuse services and supports" on a prepaid, shared risk basis. DCA Ex. 5, at 14; *see* 42 C.F.R. Part 438. MDCH was to pay Detroit-Wayne on the basis of an actuarially-determined "capitation rate" approved by the Centers for Medicare & Medicaid Services (CMS). CMS is the HHS division that administers the Medicaid program at the federal level. The contract defined "capitation rate" as the "fixed per person monthly rate payable to the PIHP by the MDCH for each Medicaid eligible person … regardless of whether or not the individual who is eligible for Medicaid receives covered specialty services and supports during the month."[3] DCA Ex. 5, at 10. In the event that MDCH's payments to Detroit-Wayne for the year exceeded Detroit-Wayne's expenditures under the contract, the contract provided for Detroit-Wayne and MDCH to share the unexpended funds according to set formulas, with Detroit-Wayne to retain all unexpended funds up to a threshold amount, and half of unexpended funds up to a second threshold.[4] *Id.* at 70-71.

As relevant here, Detroit-Wayne could "retain unexpended Medicaid Capitation funds up to 7.5% of the Medicaid pre-payment authorization," but had to return the remaining unexpended funds to MDCH. *Id.* at 71-72. The retained amount (referred to as "Medicaid savings") had to be included in a "reinvestment strategy" and "expended within one fiscal year following the fiscal year earned" unless (1) the reinvestment plan had to be approved by MDCH and CMS, in which case the "savings must be expended by the end of the fiscal year the plan is approved," or (2) a final audit "creates new Medicaid savings," in which case Detroit-Wayne had one year following the date of the audit report to reinvest the funds. *Id.* The contract further stated that "[u]nexpended Medicaid savings shall be returned to the MDCH as part of the year-end settlement process" and that "MDCH will return the federal share of the unexpended savings to CMS." *Id.* at 72.

Finally, the contract stipulated that it was "a cost reimbursement contract under OMB Circular A-87 … subject to compliance with the principles and standards" of the Circular. *Id.* at 14.

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[3] Medicaid managed care regulations define "capitation payment" as "a payment the State agency makes periodically to a contractor on behalf of each beneficiary enrolled under a contract for the provision of medical services under the State [Medicaid] plan. The State agency makes the payment regardless of whether the particular beneficiary receives services during the period covered by the payment." 42 C.F.R. § 438.2.

[4] The contract contained analogous provisions for Detroit-Wayne and MDCH to share liabilities in the event that payments to Detroit-Wayne under the contract were less than its expenditures.

B. The unfunded liabilities for post-retirement benefits

As a County government department, Detroit-Wayne participated in the Wayne County Employment Retirement System (WCERS) to provide pension benefits for its employees. WCERS operated on a fully-funded basis in FY2012. That is, the County made payments based on an actuarially-determined estimate of the pension obligations accrued during the year. The estimate was discounted since the funds were paid into a reserve fund and invested, with the funds and investment earnings to be used to meet ongoing pension obligations. DW Ex. 10, at 23, 24 (County actuary's report for FY2012). Prior to 2009, however, WCERS had operated on a cash or "pay-as-you-go" basis. Under a pay-as-you-go financing system, allowable costs are "limited to those representing actual payments to retirees or their beneficiaries." Part 225, App. B., ¶ e.(1). In 2009, WCERS implemented a plan in to amortize the unfunded liability for pension payments over a 30-year period. DW Ex. 8 at A-7. An actuarial firm determined that, as of the beginning of FY2013, WCERS's total unfunded actuarial accrued liability for pension costs was over $878 million for all current and retired County employees. *Id*. at A-6 (WCERS annual actuarial valuation report, Sept. 30, 2012). The actuarial firm later reported that as of the end of FY2014, the unfunded actuarial accrued liability for pensions for current and retired Detroit-Wayne employees would range from $21 to $23.8 million. DW Ex. 9, at numbered page 3 (supp. actuarial valuation, June 19, 2013).[5]

Wayne County also provides other post-retirement employee benefits (OPEB), including post-retirement health benefits (PRHB) and life insurance, under a single-employer defined benefit plan (OPEB plan). DW Br. at 6, 8; DCA Ex. 7, at 138. The OPEB plan is a "pay-as-you-go" system, although the County had an actuarial firm calculate the amount of annual contributions that would be required to cover the year's normal costs and to amortize the unfunded actuarial liability over a period of 30 years. DW Ex. 10, at numbered pages 3-7; DCA Ex. 7, at 16. The record indicates that the County had unfunded PRHB liabilities of more than $1.5 billion as of September 30, 2011 and September 30, 2012. DCA Ex. 7, at 16; DW Ex. 10, at numbered pages 3-6 and App. A at 1. The unfunded actuarial accrued liability for retiree health benefits for Detroit-Wayne's existing active and retired employees was estimated to be over $20 million as of September 30, 2012. DW Ex. 11, at 1.

[5] The reason this is a range is that the actual amount might depend on whether there are more retirees and associated liabilities for Detroit-Wayne former employees than identified by WCERS staff to the actuaries. DW Ex. 9, at report pages 2, 3.

C. Detroit-Wayne's proposal and DCA's response

Detroit-Wayne reports having "discovered in Spring, 2013" that it had "failed to spend … Medicaid funding provided to it for FY 2012" due to "a computer system programming error that resulted in failure accurately to track Medicaid encounter data …." DW Br. at 7. Detroit-Wayne initially reported the amount of unspent FY2012 funds as more than $16 million, but during the appeal stated that the correct amount is $4.8 million, a reduction it says resulted from the completion of an audit of the Financial Status Report (FSR) in which Detroit-Wayne had initially identified the higher figure. DW Reply Br. at 1 n.1. Detroit-Wayne asked MDCH for approval "to use the lapsed funds to fund the pension and retiree healthcare liabilities that will be required to be reported under the new Authority" Detroit-Wayne would become on October 1, 2013. DW Ex. 12, at 3. Detroit-Wayne informed MDCH that "[c]urrently . . . Medicaid savings are fully funded at 7.5%, the capped amount per the PIHP contract." *Id.*

MDCH denied the request on the grounds that using the Medicaid funds to pay down the pension and OPEB liabilities would not comply with Detroit-Wayne's contract or the federal program and stated that "[t]he only way to retain Medicaid funds rather than lapsing the funds back to MDCH would be to amend the FYE 2012 FSR to report additional allowable Medicaid costs in accordance with contract provisions." *Id.* at 12th page. When Detroit-Wayne then proposed to amend its FSR to use Medicaid funds to pay pension and OPEB liabilities, MDCH replied that Detroit-Wayne would "need to seek cognizant agency approval from HHS to extend the funding period of the pension and OPEB costs." *Id.* at 13th-15th pages.

On July 22, 2013, Detroit-Wayne submitted a request to DCA to "grant an eleven month extension (August 31, 2013) to fund the fringe benefits in 2012." DW Ex. 13, 2nd page. The letter explained that Detroit-Wayne had received supplemental actuary reports to estimate the pension and other post-retirement costs for Detroit-Wayne employees and retirees. The letter asserted that the source of the funding would be Medicaid, State General Fund and local funds, rather than federal grants, but did not provide any information regarding how the costs would be allocated among all sources of funding, for either Detroit-Wayne activities or County activities.[6] *Id.*

[6] The letter also asked DCA to clarify whether it is Detroit-Wayne's cognizant agency. DCA informed Detroit-Wayne that OMB had designated HHS as the cognizant agency for cost allocation (in the *Federal Register* notice cited in note 2 above) and that DCA is the part of HHS responsible for approving cost allocation methods. On November 25, 2013, the Board Chair ruled that the Board has jurisdiction to hear the appeal after DCA stated its opinion that the Board has jurisdiction because its determination is both a Medicaid disallowance and a DCA determination regarding cost allocation.

After discussions between DCA and Detroit-Wayne staff, DCA on September 12, 2013 denied the request for an extension on the ground that no extension was needed because Wayne County had already fully funded the pension and OPEB costs for FY2012. DW Ex. 1, at 1-2. DCA also stated that Detroit-Wayne could not use unspent Medicaid funds that would otherwise be returned to the state (which would return the federal share of the funds to CMS) to pay down the accrued pension and OPEB liabilities absent corresponding contributions from the other County funding sources that participated in WCERS and the OPEB program. *Id*. at 2-5.

Regarding the OPEB liability, DCA stated that the OPEB liability would have to "be amortized over a period of years at a relatively equal percentage from year to year" as OMB Circular A-87 requires "when converting from a pay-as-you-go system to an actuarial based system." *Id*. at 5. DCA also said that it would continue to work with Detroit-Wayne "on identifying and implementing alternatives which are allowable by OMB Circular A-87," which "might include transfer of the Authority's pension assets to it, continued pay-as-you-go for OPEBs, [and] amortization of the [unfunded accrued actuarial liability] of the Authority's pension obligations and unfunded liability of OPEBs over a number of years." *Id*. at 6.

Analysis

Below, we first address each of the issues related to applying the cost principles to determine whether Detroit-Wayne may use the Medicaid funds from its FY2012 contract with MDCH to pay down its unfunded liabilities for post-retirement benefits. We then address Detroit-Wayne's arguments about the status of the funds under the Medicaid contract that have not been expended for allowable costs.

A. Applicable cost principles do not permit Detroit-Wayne to use the unexpended Medicaid funds awarded for FY2012 to pay down the unfunded liabilities for post-retirement benefits accrued in prior years.

As noted above, under the cost principles, expenditures for pension and other post-employment fringe benefits "are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit" and are "granted under established written policies." 2 C.F.R. Part 225, App. B, ¶¶ 8.d.(1), (5). Pension plan costs may be "computed using an acceptable actuarial cost method in accordance with established written policies of the governmental unit." *Id*. at ¶ 8.e. Pension costs "calculated using an actuarial cost-based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year" although "the cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund." *Id*. at

¶ 8.e.(2). PRHB costs must, like pension plan costs, be computed "in accordance with established written polices of the governmental unit." *Id.* at ¶ 8.f. PRHB costs computed on a pay-as-you-go basis, as here, are "limited to those representing actual payments to retirees or their beneficiaries." *Id.* at ¶ 8.f.(1). And as with pension costs, PRHB "calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year," a deadline that the cognizant agency may extend. *Id.* at ¶ 8.f.(2).

Detroit-Wayne has not shown that its proposed expenditure of Medicaid funds awarded for FY2012 to pay down its accrued liability for retirement-related costs meets these requirements of allowability. The record indicates instead that the costs Detroit-Wayne proposes to fund would not be allowable.

As DCA found, this is not a situation in which a governmental unit simply failed to make a timely payment to fund its share of allowable post-retirement costs, and needs more time to provide the funding.

Detroit-Wayne asked DCA to extend the period "to fund the fringe benefits in 2012" beyond the six months after the end of the fiscal year. DW Ex. 13, at 2nd page. DCA replied in correspondence that an "extension as described in OMB Circular A-87 is neither needed or approved" because Detroit-Wayne "has paid all of its FY 2012 pension and OPEB costs, at the same rate as other Wayne County departments and agencies, to the appropriate fund." DW Ex. 1, at 2 (DCA Letter Sept. 12, 2013); *see also* DCA Br. at 16 ("Detroit-Wayne already paid its necessary and reasonable share of the retirement costs for the FYs at issue" and its "proposed lump-sum payment … is in addition to its previously-allocated retirement costs …."); DW Br. at 6 ("Wayne County 'assessed' a specified percentage against each County department's payroll" and "[e]ach department paid the same percentage rate, applied against that department's payroll for employees participating in defined retirement benefit plans.").

The record indicates that the amounts that the County (and thus Detroit-Wayne, then a component of the County) paid for FY2012 pension costs consisted of two components. The first was the actuarially-determined amount accrued for FY2012 (referred to as "normal cost"). DW Ex. 8, at A-1 - A-2. The second component was a payment towards the 30-year amortization of the unfunded liability that existed when WCERS converted from a pay-as-you-go to a fully funded pension system in 2009, as permitted by Part 225. DW Ex. 8, at A-1 - A-2; Part 225, App. B, ¶ 8.e.(4)

For OPEB costs including health benefits, which Wayne County funds on a pay-as-you-go basis, the permissible contribution was limited to amounts needed for "actual payments to retirees or their beneficiaries." Part 225, App. B, ¶ 8.f.(1). Thus, the provision for extending the time period for a governmental unit to fund its share of an actuarial cost-based amount for PRHB does not apply to the OPEB costs.[7]

Before the Board, Detroit-Wayne does not deny having already funded its share of the allowable pension and OPEB costs for FY2012, as determined in accordance with the cost principles and County policy. Nor does Detroit-Wayne assert that it did not already report as expenditures under the Medicaid contract a proportionate share of these costs. Instead, Detroit-Wayne questions why the further payments it proposed would be "superfluous," and questions how DCA could consider it "reasonable" to have Detroit-Wayne remain "in the hole" for the benefits, "given that [DCA] acknowledges that there remains more than $20 million in retiree benefit liabilities attributable to the [Detroit Wayne Mental Health] Authority." DW Reply Br. at 3.

Detroit-Wayne misconstrues the basis for DCA determining that the costs of paying down the post-retirement liabilities, as Detroit-Wayne proposes, would not be "necessary and reasonable for proper and efficient performance and administration of Federal awards," as required under the general guidelines in Appendix A, paragraph C.1.a. of Part 225. Under those guidelines, a factor in considering whether a cost is "reasonable" is whether it would be a significant deviation from the established practices of the governmental unit that may unjustifiably increase the cost of a federal award. Part 225, App. A, ¶ C.2.e. DCA reasonably determined that the lump-sum payment Detroit-Wayne proposes would be such a deviation from Wayne County practices. In any event, costs must not only be "reasonable and necessary,' but they must also comply with the specific requirements applicable to different types of costs. Part 225 limits the amount of annual retirement contributions to actuarially-determined amounts for fully-funded systems (including amounts to amortize the liability existing upon conversion from a pay-as-you-go system), and to actual annual costs for pay-as-you-go systems.

Contrary to what Detroit-Wayne suggests, there are valid reasons why the cost principles limit the use of current period funds to pay for unfunded liabilities that arose in prior funding periods. First, there is no direct benefit to a federal award for a particular funding period from costs incurred outside of that period. Thus, generally, costs incurred outside of a particular funding period are not considered allocable to an award for that period (unless a particular exception applies). *N. J. Dep't of Health*, DAB No. 2497, at 4-

[7] As noted above, the OPEB also included life insurance for retirees. The cost principles do not specifically address life insurance for retirees, but provide that the allowability of a particular item of cost not specifically mentioned should be based on the treatment or standards provided for similar or related items of cost. Part 225, App. B. Thus, we treat the life insurance like the PRHB.

5 (2013); *see* 45 C.F.R. §§ 92.23, 74.28, 74.71. Here, for example, absent the provision of the Circular that specifically allowed Wayne County to amortize the liability for pension costs accrued prior to Wayne County's conversion to an actuarial cost-based system in 2009 (and to allocate that cost to federal funds, including funds awarded under the Medicaid contract), Detroit-Wayne would be hard pressed to explain how the FY2012 Medicaid contract benefited from those pre-2009 obligations.

Second, if a governmental unit could incur obligations, defer funding those obligations, and then liquidate them by making a lump-sum payment (as Detroit-Wayne proposes here), rather than amortizing the costs, the governmental unit could wait to liquidate the obligations until a year in which its federal funding was higher than usual. This would result in an inequitable allocation of costs to federal programs. Moreover, paying down the accrued liabilities all at once might leave insufficient funds for the governmental unit to successfully operate its federal programs during the funding period in which the unit chose to liquidate the obligations. The provisions of OMB Circular A-87, as revised in 1995, mitigate these potentially negative effects by requiring amortization of the liability over time and by limiting the amount amortized to the unfunded liability at the time of conversion from a cash to an accrual basis of accounting for the costs.

Detroit-Wayne overlooks the requirement of allocability when it argues that the unspent Medicaid funds, "had they been timely discovered by [Detroit-Wayne] /Wayne County, would have been spent on allowable programs (which could potentially have included a pay down of pension liabilities)." DW Reply Br. at 6. Detroit-Wayne had an ongoing obligation to document that any costs charged to the Medicaid funds it received met all applicable requirements of allowability, including the requirements that costs be allocable. Detroit-Wayne has not met its basic burden of showing that the proposed lump sum payments of FY2012 Medicaid funds to pay down accrued retirement-related liabilities from other periods would be allowable under the applicable cost principles. Instead, Detroit Wayne seeks to use Medicaid funds from FY2012, which are primarily federal, to pay down unfunded liabilities in an amount determined by what funds would otherwise have to be returned to MDCH and the federal government. Detroit-Wayne does not assert that its proposed lump-sum payments are permitted by any state or county cost allocation plan, written agreement, or specific provisions of the cost principles, or that the amounts it would pay have been actuarially determined in accordance with GAAP.[8]

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[8] As a "major local government" designated by OMB, the County is required by Part 225 to submit annually to its cognizant agency a cost allocation plan in order to claim "central service costs," which may include fringe benefits such as pension and post-retirement health insurance plans. Part 225, App. C, ¶¶ A-E; E.3.d; *see* 51 Fed. Reg. 552 (OMB notice designating HHS as Wayne County's cognizant agency); 78 Fed. Reg. 78,590, 78,606 (Dec. 26, 2013) (OMB "Final guidance" stating that "[t]he 'major local governments' subject to this requirement [to submit plans annually], along with each cognizant agency assignment, are listed in the Federal Register notice dated January 6, 1986").

In sum, Detroit-Wayne made its allowable retirement-related payments for FY2012 and cannot require the federal Medicaid program to provide further funding for additional payments in excess of the allowable amounts.

B. The proposed use of the funds violates the requirements in the cost principles that costs charged to federal awards be accorded consistent treatment.

While a state or county's employer contributions to pension plans for retirement benefits for its employees who work on federally-funded programs are allowable as employee benefits under OMB Circular A-87, such benefits "must be granted under approved plans and be distributed equitably to grant programs and to other activities, and are subject to basic requirements affecting allowability of costs set out in the Circular." *Maine Dep't of Admin. & Fin. Servs.*, DAB No. 1659, at 2 (1998), *aff'd*, *Maine v. Shalala*, 81 F. Supp. 2d 91 (D. Me. 1999); *Cal. Dep't of Fin.*, DAB No. 1592, at 2 (1996). Among the basic, overarching requirements in the Circular (i.e., Part 225) are that the costs charged "[b]e accorded consistent treatment" and "[b]e consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit." Part 225, App. A, ¶¶ C.1.f, e. The Board has held that a state government grantee "violates these consistency principles when the federal government has been charged at a higher rate than the state paid on similar cost items, such as retirement benefits or pension funds." *Maine Dep't of Admin. & Fin. Servs.* at 6 (citing *W.Va. Dep't of Admin.*, DAB No. 1465 (1994); *Ind. Pub. Emps. Ret. Fund*, DAB No. 314 (1982), *aff'd*, *Bd. of Trustees of the Pub. Emps. Ret. Fund of the State of Ind. v. Sullivan*, 936 F.2d 988 (7th Cir. 1991), *cert. denied*, 502 U.S. 1072 (1992)). "As the court stated in *Indiana*, the applicable law provides that a state 'may not allocate to federal programs costs greater than those the state charges to itself for an equivalent slice of the employee's time.'" *Id*. (citing 936 F.2d at 990).

Such prohibited inconsistent treatment of costs has occurred when a state charged state agencies that received federal funding more for central services costs provided through an internal service fund than it did its state agencies that had no federal funding (*Ark. Dep't of Info. Sys.*, DAB No. 2047 (2006)); reduced insurance premiums for state agencies that received most of their funding from the state but not for agencies whose funding came mostly from federal sources (*La. Div. of Admin.*, DAB No. 1893 (2003), *aff'd*, *State of La. Div. of Admin. v. HHS*, No. 03-856-A (M.D. La. June 27, 2005)); made cash contributions only for the federal share of accrued leave (*N.Y. State Dept. of Family Assistance*, DAB No. 1775 (2001)); or calculated federal and state contributions to a retirement fund differently (*Ind. Pub. Emps. Ret. Fund*). Detroit-Wayne's proposal to use primarily federal Medicaid funds to pay down the accrued liabilities of the County for pension and OPEB would likewise violate the consistency principles absent corresponding payments from other sources of funding for County activities.

As the court stated in *Indiana*, a state (or other governmental unit) "may not claim 100% in cash up front from the federal government if it is unwilling to put the retirement program for other state employees on an equivalently well-funded basis." 936 F.2d at 992.

DCE found that if the County were "to pay its liability now in the relative proportion that [Detroit-Wayne] is proposing to do, it would have to pay roughly $850+ million to the WCERS" and that "[i]t is clear that this cannot happen." DW Ex. 1, at 4. Detroit-Wayne has not challenged that finding.

C. Detroit-Wayne's arguments about being an entity apart from the County do not provide a basis to reverse DCA's determination.

Detroit-Wayne argues that its proposed use of the FY2012 Medicaid funds is consistent with the cost principles because it "is a separate and independent governmental entity [and its] use of its unspent Medicaid funding to pay down its inherited retirement liabilities is unrelated to Wayne County." DW Br. at 10. Detroit-Wayne accordingly asserts that paying down the accrued liabilities even absent corresponding payments from the County would not violate the requirement in Part 225 that allowable costs "be consistent with policies, regulations and procedures that apply uniformly to both Federal awards and other activities of **the governmental unit**" because it, and not the County, is "the relevant 'governmental unit'" at issue. *Id*. at 11-12, citing Part 225, App. A, ¶ C.1.e. (DW emphasis).

This argument is not valid because Detroit-Wayne did not become an independent governmental entity until the start of FY2014, and the County is thus the relevant unit of government for purposes of determining the allowability of costs under the FY2012 contract. Detroit-Wayne admits that, prior to its conversion to an Authority effective October 1, 2013, it "operated as a department within Wayne County, subject to County policies." DW Br. at 5.

Indeed, Detroit-Wayne in a September 17, 2013 letter to DCA conceded that, under Michigan law at the time, it was "an official county agency" that was "subject to generally applicable County policies and, in particular, County policies governing employment and retirement issues," and that, "[a]s a result of the County's policies, the County has incurred significant accrued unfunded pension and retiree health care liabilities with respect to all of its employees and retirees . . . ." DW Ex. 14, at numbered page 3. As indicated above, the cost principles require generally that costs be "consistent with policies . . . that apply uniformly to both Federal awards and other activities of the governmental unit."

Thus, the County is the relevant governmental unit for purposes of determining the allowability of expenditures charged to FY2012 Medicaid funds. Under the cost principles, County policies are important not only for determining whether particular costs are paid on a cash, accrual, or other accounting basis, but also whether fringe benefit costs are charged consistently as direct or indirect costs and how they are allocated among County cost objectives. Detroit-Wayne does not allege that the amount it seeks to charge to Medicaid for post-retirement costs is consistent with an approved County cost allocation plan.

Detroit-Wayne also does not dispute DCA's determination that Detroit-Wayne's employees will continue to contribute to WCERS through the end of FY 2014, and that Detroit-Wayne remains obligated for its share of unfunded pension and post-retirement health benefit liabilities owed to WCERS and the County. DCA Br. at 25, citing DW Ex. 6, at 9-10. The accrued liabilities for pension costs with respect to employees (and retirees) who were employed by Detroit-Wayne when it became an independent authority on October 1, 2013 are still part of the unfunded accrued actuarial liability under WCERS, the County's pension system.

Detroit-Wayne asserts that its employees "will be accounted for separately" in WCERS, in the same manner that WCERS separately accounts for the County Airports Authority, whose pension contributions and liabilities are listed separately in the WCERS actuary's report. DW Br. at 8; DW Ex. 8, at A-2, A-3, A-4. Separate accounting might address one concern underlying DCA's determination by helping to ensure that Detroit-Wayne's payments to reduce accrued pension liabilities would benefit only Detroit-Wayne's employees and retirees. Separate accounting would not, however, address another basis for DCA's determination -- that the cost principles do not permit federal funding for a lump-sum payment for accrued pension liabilities from prior years, and instead require periodic payments of actuarially-determined amounts to amortize the unfunded liability (at the time of conversion to an actuarial cost-based method) over an approved period, such as 30 years.[9] Part 225, App B, ¶¶ 8.e.(2), (4).

We also note that, since the County had previously changed to an actuarial-based method for determining WCERS pension costs, the allowable pension costs for federal purposes (at least at this time) are the actuarially determined amounts accrued each year, plus the amount each year of the "unfunded liability at the time of conversion" amortized in accordance with GAAP (so long as these amounts are timely funded). It appears some of WCER's unfunded liabilities accrued in periods **after** the time of the County's

[9] We also note that Detroit-Wayne has not stated when separate accounting would start, so it is not clear that separate accounting would prevent the lump-sum contribution of FY2012 Medicaid funds from benefitting other federal or non-federal programs that are not making comparable lump sum payments to WCERS and to the County OPEB system.

conversion in 2009 for reasons such as the County's failure to timely fund the actuarially determined amount for a year or because the investment income from the reserve was overestimated. *See* DCA Ex. 6, at 1 (County Executive attributes pension liabilities to "stock market losses"), 2 (showing low amounts paid into pension plans previously); 3 (WCERS assumed 8% return on investment, but has averaged about 6%). These amounts would not be part of the "unfunded liability at the time of conversion" that a governmental unit may amortize over a period of time under the cost principles.

D. Detroit-Wayne's reliance on a court decision from 1992 is misplaced.

Detroit-Wayne relies on the court decision in *Commonwealth v. Sullivan*, 803 F. Supp. 475 (D. Mass. 1992), which reversed and remanded the Board's decision in *The Mass. Executive Office for Admin. & Fin.*, DAB No. 1034 (1989). The court remanded the issue of whether Massachusetts could claim federal funding in an allocable share of costs of paying down unfunded accrued liabilities for pension costs when the state planned to adopt an actuarial cost-based system but was still on a pay-as-you-go system. Detroit-Wayne cites the court's statements that Massachusetts' "comprehensive efforts to eliminate its unfunded pension liability were, and continue to be, consistent" with a state's "responsibility" under OMB Circular A-87 as then in effect "for the efficient administration of grant and contract programs through the application of sound management practices." 803 F. Supp. at 479, citing OMB Circular A-87, ¶ A.2.a (46 Fed. Reg. 9548 (Jan. 28, 1981)). The court remanded the case for further consideration because it determined that the cost principles then in effect did not unambiguously require that a grantee choose between either a pay-as-you-go or an actuarial basis of funding pension costs.

That 1992 court decision is inapposite here because OMB in 1995 revised Circular A-87 to specifically address the situation of unfunded liabilities accrued under a pay-as-you-go system. OMB Circular A-87, Att. B, ¶ 11.e.(4) (60 Fed. Reg. 26,484, 26,495 (May 17, 1995)); Part 225, App. B, ¶ 8.e.(4). The revised cost principles permit a governmental unit to convert from a cash to an accrual basis of accounting for pension costs, but require the unit to use an actuarial cost-based method consistent with GAAP and to amortize the unfunded liability at the time of conversion over a set period (usually 30 years). The revised principles also clarify the need for timely funding by the governmental unit as a prerequisite for charging federal funds for pension and PRHB costs determined on an actuarial cost-based method. As discussed above, valid reasons exist for limiting the use of current period funds to pay down unfunded liabilities from prior funding periods.

E. DCA's determination is not inconsistent with the purposes of OMB Circular A-87.

Detroit-Wayne also argues that paying down the unfunded liabilities would be consistent with purpose of OMB Circular A-87. Specifically, Detroit-Wayne relies on the statement that the Circular "establishes principles and standards to provide a uniform approach to

determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government." DW Br. at 13, quoting language from Part 225, § 225.20. According to Detroit-Wayne, DCA's decision will force Detroit-Wayne to divert millions of dollars annually to pay down the retirement liabilities it inherited from the County, through no fault of its own. Such a crippling of its ability to provide services to its vulnerable customers, Detroit-Wayne argues, would contradict the Circular's stated policy of promoting effective program delivery, efficiency and better relationships between governmental units and the federal government. Detroit-Wayne asserts that, because it has no ability to levy taxes, Medicaid funds will have to be used now or later to cover the unfunded actuarial accrued liability. According to Detroit-Wayne, the "only question is whether such funding will come from the prior year's unspent Medicaid funds – a result that preserves [Detroit-Wayne]'s ability to provide future program services – or from future Medicaid funding, at the direct expense of program services." DW Br. at 13.

This argument has no merit. It focuses on the second part of the quoted policy statement and ignores the first part. The lead-in language makes it clear that the way the Circular will promote the stated goals is through the establishment of "principles and standards." Detroit-Wayne is in effect asking DCA to ignore what those principles and standards provide.

Moreover, to say that it is "DCA's decision" that will cause the undesirable effects that Detroit-Wayne predicts is hardly fair. It was the County that chose not to fund the liabilities on an ongoing basis in the first instance. Also, DCA offered to work with Detroit-Wayne to develop a plan for addressing the situation in a manner consistent with the applicable cost principles and standards. By working with DCA to develop such an acceptable method for allocating part of the costs among benefitting cost objectives, Detroit-Wayne may be able to mitigate any possible negative effects on service delivery.

Contrary to what Detroit-Wayne suggests, its inability to levy taxes has no bearing on whether it should be able to charge to future Medicaid funds the full amount (or most) of the unfunded liabilities, rather than only that part of those liabilities that are allowable and allocable under the cost principles. Since the County had previously changed to an actuarial-based method for determining WCERS pension costs, the allowable pension costs for federal purposes (at least at this time) are the actuarially determined amounts accrued each year, plus the amount each year of the "unfunded liability at the time of conversion" amortized in accordance with GAAP (so long as these amounts are timely funded). Also, the amortized amount for unfunded liabilities at the time of conversion would have to be allocated among all benefitting cost objectives according to the relative benefits received.

While most of Detroit-Wayne's funds come from the PIHP contract, moreover, allocation of the post-retirement costs does not depend on the relative amount of funding from various sources. Instead, employer contributions for pension plan and similar costs "shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities." Part 225, App. B, ¶ 8.d.(5). The record shows that most of the funds Detroit-Wayne receives from MDCH under the PHIP contract are passed through to subcontractors and that Detroit-Wayne provides administrative oversight, but does not provide any direct services to consumers. DW Ex. 7, at 8. Thus, even though most of Detroit-Wayne's revenues come from the Medicaid PIHP contract that does not necessarily mean that most of its costs for employee fringe benefits are chargeable to that contract.

In sum, we disagree with Detroit-Wayne's assertions that denial of Detroit-Wayne's request is inconsistent with the stated policies of the Circular and that this is just a case of Medicaid paying now or later for the unfunded liabilities.

F. Detroit-Wayne's contract with MDCH does not permit Detroit Wayne to retain the Medicaid funds at issue.

As noted above, MDCH told Detroit-Wayne that the only way it could retain any of the funds paid to it under its contract with MDCH in excess of the expenditure amounts reported on the FSR for FY2012 was if Detroit-Wayne got approval to apply the funds to the unfunded retirement liabilities and amended the FSR accordingly to report additional, allowable costs. DW Ex. 12, at 12th page. Having denied Detroit-Wayne the requested approval to use the Medicaid funds to cover any unfunded retirement liabilities and determined that any resulting costs would not be allowable under the applicable cost principles, DCA also said in its brief that the funds were not expended in accordance with the contract, and that the federal share should be returned. In its reply brief, Detroit-Wayne took issue with DCA's conclusions, arguing that the contract did not require it to pay back the funds. DW Reply Br. at 6-7.

We disagree. The contract provides that it is a cost-reimbursement contract, with allowable costs to be determined according to OMB Circular A-87 and reported on the FSR. DCA Ex. 5, at 14, 55, 69. The record indicates that the amounts at issue have not been expended for any purpose, much less for allowable costs. Detroit-Wayne has consistently referred to the $16 million as "unspent Medicaid funds" or "lapsed" funds, and, after its FY2012 FSR was revised and audited, it still referred to the $4.8 million as "unspent Medicaid funds." DW Ex. 12, at 3; DW Br. at 7; DW Reply Br. at 1-3, 7. Moreover, MDCH told Detroit-Wayne that if it did not get DCA approval to use the funds as proposed and then report additional, allowable costs on the FY2012 FSR, it needed to return the funds. DW Ex. 12, at 12th page.

As noted above, section 1903(d)(2)(C) of the Act requires states to refund the federal share of any Medicaid overpayment "made by a State to a person or entity," such as a provider, unless the provider is bankrupt or out of business. Applicable regulations define "overpayment" as the amount a state Medicaid agency pays "to a provider which is in excess of the amount that is allowable for services furnished under section 1902 of the Act and which is required to be refunded under section 1903 of the Act." 42 C.F.R. § 433.304. A "provider" includes, for the managed care program, "any individual or entity that is engaged in the delivery of health care services and is legally authorized to do so by the State in which it delivers the services." 42 C.F.R. §§ 400.203, 433.304. Detroit-Wayne's contract with MDCH stated that the PIHP (Detroit-Wayne) was to "provide a comprehensive array of specialty mental health and substance abuse services and supports. . . ." DCA Ex. 5, at 14. Thus, although Detroit Wayne primarily managed the provision of services by subcontractors, it was still the entity responsible to the state agency, MDCH, for furnishing those services and thus a provider under the Act. To the extent that MDCH made capitated payments to Detroit-Wayne (as a PHIP) in excess of the amount it has properly accounted for with allowable costs under the PIHP contract, the excess amount constitutes an overpayment to Detroit-Wayne of which the state must return the federal share.[10]

While the contract permits Detroit-Wayne to retain unexpended Medicaid funds up to a maximum of "7.5% of the Medicaid pre-payment authorization" and to expend those funds in a subsequent period according to a reinvestment strategy, Detroit-Wayne has effectively conceded that it has already retained the maximum percentage, which is apart from the funds it proposed to use to pay down retirement liabilities. DCA Ex. 5, at 71; DW Ex. 12, at 3 (Detroit-Wayne letter to MDCH May 31, 2013, stating "[c]urrently … Medicaid savings are fully funded at 7.5%, the capped amount per the PIHP contract"); DW Ex. 13, at 2nd page (Detroit-Wayne letter to DCA July 22, 2013 stating that Detroit-Wayne "has some funds to pay allowable administrative costs that would otherwise [be] returned to MDCH"). Section 7.7.1 of the contract allowed Detroit-Wayne to retain the 7.5% (specifically, "unexpended risk-corridor-related funds between 95% and 100% of said funds" and "50% of unexpended risk-corridor related funds between 90% and 95% of said funds"), but required Detroit-Wayne to return the remaining "unexpended" funds to MDCH. DCA Ex. 5, at 70-71.

Detroit-Wayne cites to a different provision of the contract, section 7.7.2, which requires that "[u]nexpended Medicaid **savings** shall be returned to the MDCH as part of the year-end settlement process" and that "MDCH will return the federal share of the unexpended

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[10] DCA reports that in FYs 2011, 2012 and 2013, CMS "generally funded the Michigan Medicaid program at 65.79%, 66.14% and 66.39%, respectively, of expenditures," with higher percentage provided for certain expenditures eligible for enhanced federal funding. DCA Br. at 7, citing 76 Fed. Reg. 74,061-63 (Nov. 30, 2011); 75 Fed. Reg. 69,082-84 (Nov. 10, 2010); 74 Fed. Reg. 62,315-17 (Nov. 27, 2009).

savings to CMS." *Id.* at 72 (emphasis added). Detroit-Wayne argues that that this provision does not apply to the $4.8 million in unexpended Medicaid funds it proposes to use for retirement-related liabilities. According to Detroit-Wayne, these funds are not "savings from pre-payments" because they "do not represent a bonus received by [Detroit-Wayne] through implementation of efficiencies, but rather result from clerical errors." DW Reply Br. at 6. Detroit-Wayne does not cite to any definition of "savings" in the contract, and we see nothing in the contract that limits the term "Medicaid savings" to amounts resulting from "efficiencies" in service delivery or excludes amounts that were not timely spent because of clerical errors.

In any event, it does not matter whether the $4.8 million (or later determined final amount) is considered "Medicaid savings" under the contract. The record indicates that the $4.8 million represents that part of the FY2012 capitated payments made to Detroit-Wayne to provide Medicaid services that exceeded the reported, audited expenditures for FY2012 under the contract and was not part of the 7.5% Detroit-Wayne was permitted to retain. Thus, the applicable contract provision is section 7.7.1, which required Detroit-Wayne to return unexpended funds that were not part of the 7.5%.

Detroit-Wayne also argues that, if the funds are considered "Medicaid savings," it "should have at least a year following the date in which [the unspent funds] were discovered to expend those funds under the PIHP Agreement." *Id.* at 7. Detroit-Wayne relies on contract language stating that "[i]n the event that a final MDCH audit report creates new Medicaid savings, the PIHP will have one year following the date of the final audit report to expend those funds according to Section 7.7.2.2," which requires reinvestment of all Medicaid savings. DCA Ex. 5, at 72. The requirement to reinvest Medicaid savings, however, applies only to unexpended funds within the maximum of "7.5% of the Medicaid pre-payment authorization," which amount, as discussed, was satisfied for FY2012 and does not include the additional $4.8 million Detroit Wayne proposes to use here. We also question whether the $4.8 million qualifies as "new Medicaid savings" created by a final audit, given that the audit reduced the amount of "unexpended" or "lapsed" Medicaid funds from the over $16 million that Detroit Wayne initially reported. Since the audit apparently determined that Medicaid **expenditures** were higher than the expenditures previously reported, Detroit-Wayne cannot reasonably view the audit as creating "new savings" available for reinvestment under the contract.

We thus conclude that the contract does not permit Detroit-Wayne to retain the unspent Medicaid funds from FY2012 at issue here.

Conclusion

For the reasons explained above, we sustain DCA's determination.

/s/
Leslie A. Sussan

/s/
Constance B. Tobias

/s/
Judith A. Ballard
Presiding Board Member