Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

New Jersey Department of Human Services
Docket No. A-10-4
Decision No. 2328
August 5, 2010

DECISION

The New Jersey Department of Human Services (DHS), the State Medicaid agency, appealed a determination by CMS disallowing federal Medicaid funding totaling $2,513,951 for the period October 1, 2001 through September 30, 2007. The claims were for costs of the Office of the Ombudsman for the Institutionalized Elderly (OOIE), part of another state agency. DHS allocated to Medicaid some of the costs of OOIE's activities, including investigations. CMS disallowed the full amount claimed on the ground that DHS had not shown that the costs were necessary for the proper and efficient administration of its Medicaid State plan.

For the reasons set out below, we uphold the disallowance.

Legal Background

The Medicaid program, established under title XIX of the Social Security Act (Act), provides medical care to financially needy and disabled persons.[1] The federal government and states share the funding of program costs. Sections 1901, 1903 of the Act; 42 C.F.R. § 430.0. Each state establishes and administers its own Medicaid program, subject to various federal requirements and the terms of its "plan for medical assistance" (Medicaid state plan), which must be approved by the Secretary of the Department of Health and Human Services (HHS). Section 1902 of the Act; 42 C.F.R. §§ 430.10-430.16. Once a state plan is approved, the state becomes entitled to receive federal financial participation (FFP) for a percentage of its program-related expenditures. Section 1903(a)(7) of the Act directs payment of FFP at a 50 percent matching rate for costs "found necessary by the Secretary for the proper and efficient administration of the State plan" which are not identified elsewhere in that section as eligible for a higher matching rate.

---

[1] The current version of the Act can be found at http://www.socialsecurity.gov/OP_Home/ssact/ssact.htm. Each section of the Act on that website contains a reference to the corresponding United States Code chapter and section.

Part 95 of 45 C.F.R. requires a state to claim federal funding for all state agency costs incurred in support of public assistance programs (including Medicaid) in accordance with a cost allocation plan (CAP) approved by HHS's Division of Cost Allocation following consultation with the affected HHS operating division. See §§ 95.503, 95.507, 95.511(a), and 95.517(a). The CAP must "[d]escribe the procedures used to identify, measure, and allocate all costs to each of the programs operated by the State agency" and "[c]onform to the accounting principles and standards in Office of Management and Budget Circular A–87" ("Cost Principles for State, Local and Indian Tribal Governments" (OMB A-87)). 45 C.F.R. §§ 95.507(a)(1) and (2). However, the CAP need not describe the procedures for allocating costs claimed for services provided by a governmental agency outside the state Medicaid agency if the CAP includes a statement stipulating that such costs—

> will be supported by a written agreement that includes, at a minimum (i) the specific service(s) being purchased, (ii) the basis upon which the billing will be made by the provider agency (e.g. time reports, number of homes inspected, etc.) and (iii) a stipulation that the billing will be based on the actual cost incurred.

45 C.F.R. § 95.507(b)(6).

OMB A-87, now codified, sets forth general principles for determining allowable costs. 2 C.F.R. Part 225, Appendix (App.) A (2009).[2] To be allowable, costs must be "necessary and reasonable for [the] proper and efficient performance and administration" of the award. 2 C.F.R. Part 225, Appendix (App.) A, ¶ C.1.a. In addition, in order to be allowable, a cost must be allocable to the award. *Id.*, ¶ C.1.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.*, ¶ C.3.a. The Circular also provides:

> Any cost allocable to a particular Federal award or cost objective under the principles provided for in 2 CFR part 225 may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.

2 C.F.R. Part 225, App. A, ¶ C.3.c.

---

[2] The codified version of OMB A-87 to which we cite is the version published in 2004 at 69 Fed. Reg. 25,970. *See* 70 Fed. Reg. 51,910 (2005). Except as discussed later, the provisions cited do not differ from those in the version published in 1995 at 60 Fed. Reg. 26,484. Prior to codification, the appendices to OMB A-87 were denominated "attachments."

The uniform administrative requirements for grants at 45 C.F.R. Parts 74 and 92 require that a grantee maintain "financial management systems" that provide for records that identify adequately the source and application of funds awarded and accounting records that are supported by source documentation, consistent with the applicable cost principles in OMB A-87.[3] 45 C.F.R. §§ 74.21(b)(2), 74.21(b)(7), 74.27(a); 45 C.F.R. §§ 92.20(b)(2), 92.20(b)(6), 92.22(b).

The State Long-Term Care Ombudsman program was established by title III of the Older Americans Act (OAA) in 1978 as a demonstration program and was transferred to a new title VII of the OAA (which also includes other programs) in 1992. The title VII long-term care ombudsman program, administered by HHS's Administration on Aging (AoA), requires every state to carry out a long-term care ombudsman program that performs specified functions. These functions include identifying, investigating, and resolving complaints made by, or on behalf of, older residents of long-term care facilities; providing services to assist such residents in protecting their health, safety, welfare and rights; representing the interest of such residents before governmental agencies; and seeking administrative, legal and other remedies to protect such residents. OAA, section 712. State long-term care ombudsman programs are funded by an annual allotment authorized by title VII and may also receive other title VII and title III funds, as well as state, local and private funds. *See* http://www.aoa.gov/AoARoot/AoA_Programs/Elder_Rights/Ombudsman/index.aspx/ (AoA Programs website).

Case Background

The following facts are undisputed.

OOIE was established pursuant to state legislation enacted in 1977, predating the amendments to the OAA that required each state to create and administer a long-term care ombudsman program. DHS Br. at 16, citing N.J.S.A. 52:27G-1 (1977). In 1991, OOIE entered into an agreement with DHS's Division of Medical Assistance and Health Services (DMAHS) under which DMAHS agreed to submit a claim for federal Medicaid reimbursement for the cost of OOIE "Medicaid eligible activities." DHS appeal file, Aa6. The agreement specified the following activities for which Medicaid claims could be submitted: investigating any case "of suspected abuse or complaint of poor patient care or patient exploitation of elderly . . . patients, residents or clients of health care practitioners" and "complaints referred by DMAHS concerning health care facility

[3] For part of the period for which the claims at issue here were made, the administrative requirements at 45 C.F.R. Part 74 (with certain exceptions not relevant here) applied to Medicaid and other HHS entitlement grants. In 2003, the Secretary made the administrative requirements at 45 C.F.R. Part 92 (rather than Part 74) applicable to these grants. 68 Fed. Reg. 52,843 (Sept. 8, 2003). Parts 74 and 92 both require states to use OMB A-87 to determine the allowability of costs.

structure and/or quality of service delivery." DHS appeal file, Aa5. OOIE agreed to advise DMAHS "of all cases under investigation that involve individuals covered by Medicaid or that involve health care facilities participating in the Medicaid program" and to report "the cost of OIE Medicaid eligible activities to DMAHS each calendar quarter based upon generally accepted cost accounting principles." *Id.*

Pursuant to this agreement, DHS claimed Medicaid funding for part of OOIE's costs for each quarter during the period October 1, 2001 through September 30, 2007 based on the number of investigations conducted by OOIE in "Medicaid cases" divided by the total number of investigations conducted by OOIE (expressed as a percentage).[4] *See, e.g.,* DHS appeal file, Aa20. The percentage was calculated for each quarter and was applied to OOIE's total costs for the quarter. *Id.*

CMS deferred payment of some of DHS's quarterly claims for OOIE costs, stating in each of the deferral letters that "the State did not provide adequate documentation to support the claim." CMS Appendix, Ra15-20. DHS was given an opportunity to provide additional documents and materials in support of the deferred claims. *See id.* By letter dated August 27, 2009, CMS advised DHS that it was disallowing $2,513,951 FFP, stating that "Medicaid funded reimbursable administrative costs must be directly related to, that is, necessary for the proper and efficient administration of, the Medicaid State plan or waiver services." DHS appeal file, Aa2. CMS found that "New Jersey has not identified any activities provided by the Office of the Ombudsman that would be considered allowable costs associated with the administration of the Medicaid program nor has New Jersey provided the documentation requested by CMS to support its claim." *Id.* As authority for the disallowance, CMS cited 45 C.F.R. § 92.20(b)(6), OMB A-87, Attachment A, ¶ C.3.c, and a December 20, 1994 State Medicaid Director Letter (SMDL) (addressed to State Medicaid Directors) regarding Medicaid policy on allowable administrative costs.

Analysis

The Board has consistently held that a state has the burden to document the allowability and allocability of its claims for FFP. *E.g.*, *New Jersey Dept. of Human Services*, DAB No. 2318, at 5 (2010) (citing, inter alia, the reporting and record retention requirements at 45 C.F.R. Part 74); *see also California Dept. of Health Services*, DAB No. 1606 (1996) ("It is a fundamental principle that a state has the initial burden to document its costs and

---

[4] CMS's disallowance letter indicates, and DHS does not dispute, that the number of investigations in the dividend was "based on a recipient count of Medicaid eligibles." DHS Br. at 14 (quoting disallowance letter). It is unclear if this refers only to Medicaid recipients or also to individuals eligible for but not receiving Medicaid. DHS may also have included in the dividend investigations involving individuals residing in a "Medicaid licensed facility" regardless of whether they were Medicaid recipients. *See, e.g.,* CMS Appendix, Ra8. How DHS determined which investigations were related to Medicaid is not material to our conclusions below, however.

to show that its claim for reimbursement is proper."). For the reasons discussed below, we conclude that DHS has not met that burden here.

1. DHS's methodology was not included in its approved CAP as required by the applicable regulations and did not fall within the exception to this requirement for services purchased from outside agencies.

As noted above, 45 C.F.R. Part 95 requires that federal funding for all state agency costs incurred in support of public assistance programs be claimed in accordance with an approved CAP. DHS admits that its approved CAP did not include any methodology for allocating OOIE costs to Medicaid. DHS Reply Br. at 5. DHS maintains, however, that this was not required because the 1991 agreement between OOIE and DMAHS contained all the information required by 45 C.F.R. § 95.507(b)(6). *Id.* at 6-7. We find that the agreement on which DHS relies does not contain this information.

Section 95.507(b)(6) requires that an agreement to purchase the services whose costs are to be allocated specify the services "being purchased." In the 1991 agreement, however, DMAHS did not agree to purchase specific services from OOIE. DMAHS merely agreed to bill Medicaid for the cost of any investigations that OOIE conducted in Medicaid cases. Furthermore, even if that billing agreement could be considered a purchase of services (and we conclude it cannot), OOIE did not agree to conduct a specified number of such investigations, or indeed any such investigations at all. Section 95.507(b)(6) also requires that the agreement specify the basis upon which billing will be made by the outside agency. In this case, the agreement states only that OOIE will report the cost of the investigations "based upon generally accepted cost accounting principles," a statement so general as to be effectively meaningless. Moreover, nothing in the agreement indicates that Medicaid will be billed based on actual costs incurred, as also required by section 95.507(b)(6).

Section 95.519 of 45 C.F.R. states that if "costs under a Public Assistance program are not claimed in accordance with the approved cost allocation plan . . . , the costs improperly claimed will be disallowed" (except under the circumstances specified in section 95.517, which are not relevant here). Accordingly, we conclude that the claims at issue are unallowable on the grounds that the allocation method DHS used to calculate the claims was not included in DHS's approved CAP and DHS did not have a purchase agreement with OOIE within the meaning or otherwise meeting the requirements of section 95.507(b)(6).

2. The methodology DHS used to allocate OOIE costs to Medicaid was inconsistent with the requirements of OMB A-87.

As noted above, OMB A-87 provides that a cost is allocable to a particular cost objective if the services involved are chargeable or assignable to such cost objective in accordance

with the relative benefits received. For the reasons described below, we conclude that the methodology DHS used to calculate the claims did not identify the extent to which Medicaid benefited from OOIE activities.

First, DHS allocated OOIE costs to Medicaid based on the percentage of investigations conducted by OOIE in Medicaid cases. However, DHS applied this percentage to OOIE's total costs even though DHS admits, in effect, that OOIE incurred costs not related to investigations. DHS appeal file, Aa20; DHS Br. at 17-23 (identifying the following as the OOIE functions that benefited Medicaid: investigating financial exploitation/interference with Medicaid eligibility; complaints involving other institutional care (such as care in "centers for the developmentally disabled"); intervening in transfer and discharge cases; facility centered education and outreach; and investigating Medicaid discrimination in admission). DHS has shown no logical correlation between the percentage of investigations in Medicaid cases and any benefit to Medicaid from costs not related to investigations. Thus, the percentage of such investigations was not a valid basis for allocating costs to Medicaid.

Even if DHS had shown (as it did not) that all of OOIE's activities benefited Medicaid to the same extent that OOIE's investigations benefited Medicaid, DHS's methodology was flawed. At least some of the OOIE activities that benefited Medicaid necessarily benefited New Jersey's long-term care ombudsman program as well since at least some of the activities of both programs involved residents of long-term care facilities. This would be the case even if, as DHS argues, some of the OOIE costs were not allowable under title VII of the OAA because State law gave OOIE a broader mandate than title VII. *See* DHS Br. at 16; DHS Reply Br. at 2. Once any costs that benefited Medicaid eligibles or recipients in long-term care facilities were identified, those costs should have been further allocated between Medicaid and New Jersey's long-term care ombudsman program instead of being allocated solely to Medicaid.

DHS argues, however, that OMB A-87 permits a state to charge costs that benefit more than one program to a single program. DHS relies on a sentence that appeared at the end of Attachment A, paragraph C.3.c., of the 1995 revision to OMB A-87 but was deleted when OMB A-87 was revised in 2004. The sentence stated that the prohibition in the prior sentence (on charging a cost allocable to a particular award to other federal awards) "would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements." DHS also relies on the fact that in explaining its decision to delete this sentence, OMB stated that its "policy" has always been "that where two or more programs allowed identical services to an identical eligible population, the state agency had the flexibility to decide which program to charge." *See* DHS Br. at 9 (quoting comments published at www.whitehouse.gov/ omb/ grants_cost_comparison_comments_2004/).

DHS has not, however, shown that all of the OOIE activities charged to Medicaid and the activities it could have charged to New Jersey's long-term care ombudsman program (which DHS says was broader than OAA title VII) involved "identical services to an identical eligible population." HHS's April 8, 1997 Implementation Guide for OMB A-87 explained the distinction between cost allocation and funding allocations that the 1995 provision on which DHS relies was intended to address. ASMB C-10, at 2-16. The example describing when such a funding allocation would be appropriate refers to a state allocating costs to a particular cost objective which is chargeable to either one of two programs in its entirety, and is funded by one program in its entirety until a ceiling is reached, after which the cost objective is funded by the second program. That is not what DHS did here. With respect to cost allocation, the implementation guide states that the requirement in OMB A-87 that costs must be allocated in accordance with the relative benefits received by each activity or program "is an underlying principle of cost allocation" and that "exceptions to this requirement are permissible only . . . where the head of an awarding agency determines that the agency's enabling legislation permits reimbursement of unallocable costs." ASMB C-10, at 2-12 and 2-13. Here the "awarding agency" was CMS. DHS does not claim that either the CMS Administrator or his delegate made this determination here.[5] Thus, the general rule in OMB A-87 that costs must be allocated to all benefiting programs consistent with the relative benefits received by each program applies here.

Finally, DHS does not allege that OOIE performed no activities other than the activities DHS describes as benefiting Medicaid. If OOIE performed other activities, then applying the allocation percentage to OOIE's total costs would have allocated to Medicaid some costs that were clearly of <u>no</u> benefit to that program.

Thus, we conclude that the allocation methodology used was inconsistent with the requirements of OMB A-87.

<u>3. DHS has not provided the type of supporting documentation for its claims required by the applicable regulations.</u>

As noted above, states must have accounting records, supported by source documentation, to show the allowability of costs claimed under federal awards. DHS asserts that it either provided or made available to CMS "fiscal materials to justify the <u>amount</u> of the claim[.]" DHS Br. at 24 (emphasis in original). As a "sample" of this documentation, DHS submitted documents that its Director of Financial Services says were used to calculate DHS's claim for OOIE costs for the quarter ended September 30,

---

[5] Instead, the SMDL reflects a determination to limit the administrative costs allocated to Medicaid, stating that any allocation of administrative costs to Medicaid must be "supported by a system which has the capability to isolate the costs which are directly related to the support of the Medicaid program from all other costs incurred by the agency." SMDL at 6 (DHS appeal file, Aa13).

2005. *Id.*; DHS appeal file, Aa18(unnumbered)-Aa46. The first document is an internal DHS memorandum dated October 21, 2005 with the subject "Quarterly Statement of Title 19 Expenditures for the Ombudsman's Office" with the following information:

	State Fiscal Year 2006 1st Quarter Claim
Medicaid Cases	439
Total Cases	723
Total Cost	$438,023
Medicaid Case Percentage	60.72%
Medicaid Activity Expenditures	$265,964
Federal Financial Participation Rate (FFP%)	50%
Federal Financial Participation Amount (FFP$)	$132,982

DHS appeal file, Aa20. This memorandum is followed by other documents that include: 1) an itemized list--by budget category--of OOIE's "Total Expenses" for the quarter ended 9/30/05; 2) memoranda for each month in the quarter showing the number of "Total Medicaid investigations," the number of "Total investigations for the period," and the "Percentage of investigations that were Medicaid;" 3) computer printouts showing the expenses for several cost centers identified only by number; 4) a computer printout captioned "Treasury Telephone and Postage Central Account Reports;" 5) a computer printout captioned "New Jersey Department of Treasury/Division of Administration/05-06 FY Inter-Departmental/Telephone and Postage Subsidiary Report;" 6) a similar computer printout for "04-05 FY;" 7) computer printouts captioned "2006 Rent Allocations;" 8) computer printouts captioned "New Jersey Billing Report/New Jersey Department of Treasury/Transportation Services/Billing Statement for June 2005;" 9) a chart captioned "F3 Cost for QE 9/05" showing eligible and allocated amounts for various budget categories; 10) computer printouts captioned "JOE-RPT6/New Jersey Department of Health and Senior Services/Expenses/Modifications – 07/1/05 through 9/30/05;" and 11) a chart captioned "F3 Departmental Administration Allocation Basis for the Quarter Ended 9/05." *Id.*, Aa21-Aa46.

We conclude that this documentation is inadequate. The documentation on its face purports to show only how DHS calculated Medicaid's share of OOIE costs and broad categories of costs incurred. There is nothing that shows how OOIE determined what costs were for investigations or other activities DHS identifies as benefiting Medicaid. The cost principles in OMB A-87 provide that "[w]here employees work on multiple activities or cost objectives, a distribution of their salaries and wages will be supported by personnel activity reports or equivalent documentation[.]" 2 C.F.R. Part 225, App. B, ¶ 8.h.(4). States typically use a time study to identify the time spent by personnel on activities that are related to administering the Medicaid program. *See, e.g., Texas Health & Human Services Commission*, DAB No. 2187 (2008). However, DHS provided no evidence of a time study or other documentation relating to the time spent by OOIE employees on various activities. While in some circumstances a case count method

instead of a time study may be acceptable, the validity of such a method depends on what costs are being allocated and whether case count equitably allocates the costs among benefiting programs. As discussed above, the case count here related only to investigations, yet was used to allocate all OOIE costs, and did not take into account that some investigations benefited New Jersey's long-term care ombudsman program.

DHS submitted with its reply brief other documentation—identified as "OOIE Allocation Methodology"—dating to periods before the disallowance period. The documentation consists of information from 1991 that DHS apparently used when "investigating the potential for claiming" Medicaid funding for OOIE costs, as well as information DHS used to estimate the amount of the claim for FY 1995. *See* attachment to DHS Reply Br., pages 1-28 and 29-38, respectively. A November 18, 1994 memorandum from DHS's Chief Fiscal Officer and the attached "budget of costs eligible for Medicaid reimbursement" purport to identify the percentages of those costs allocable to investigations. *Id.* at pages 29-31. There is no explanation of how these percentages were determined, however. Moreover, it is not apparent from the documents that, as DHS asserts, the methodology described by these documents "is the exact same methodology that was used in" calculating the Medicaid claim for the quarter ended September 30, 2005 (the quarter for which DHS provided the "sample" documents discussed above). DHS Reply Br. at 7. Nothing in the documents from the disallowance period shows the application of the 1991 "investigation" percentages to the cost categories before applying the case count percentage. Instead, the later documents show that OOIE was applying the case count percentage to its total costs, not merely to the costs of investigations or of other activities DHS identifies as benefiting Medicaid. *See, e.g.,* DHS appeal file, Aa20.

Accordingly, we conclude that DHS did not provide supporting documentation for the activities for which the claims were allegedly made.

4. We need not reach DHS's argument that the OOIE activities for which the claims were allegedly made were allowable Medicaid administrative activities.

DHS contends that the OOIE activities described in its brief were necessary for the proper and efficient administration of its Medicaid program and that the costs of these activities were thus eligible for Medicaid administrative funding. DHS argues that CMS improperly relied on the SMDL in concluding that the OOIE activities were not allowable Medicaid administrative activities since "that letter does not contain an all inclusive listing of allowable Medicaid administrative activities." DHS Br. at 15. DHS also cites a November 4, 2002 letter from Edwin L. Walker, Director of HHS's Office of Long-Term Care Ombudsman Programs, to CMS opining that certain types of activities performed by state ombudsman programs—which DHS says include the OOIE activities identified in its brief—are eligible for Medicaid funding. DHS Br. at 16-23; *see also id.* at 11, citing DHS appeal file, Aa16-Aa17.

Since we have concluded that the disallowance is authorized based on any one of three grounds, we need not parse the activities described by DHS to determine whether any of them might, if adequately documented, involve allowable Medicaid administrative costs. We note in any event that, contrary to what DHS suggests, CMS does not take the position that the activities described in the SMDL are an exclusive list of allowable Medicaid administrative costs. CMS argues instead that some of the activities DHS says are allowable fall within categories that the SMDL expressly states do not constitute allowable administrative costs, and that the remaining activities are not even remotely similar to the categories that the SMDL identifies as allowable administrative costs. *See* CMS Br. at 15-17. Moreover, notwithstanding its repeated references to the opinion of the Director of the Office of Long-Term Care Ombudsman Programs, DHS appears to recognize, as do we, that he had no authority to determine whether any of the OOIE costs are allowable Medicaid administrative costs. *See* DHS Br. at 15.

Conclusion

For the foregoing reasons, we uphold the disallowance in full.

/s/
Judith A. Ballard

/s/
Stephen M. Godek

/s/
Sheila Ann Hegy
Presiding Board Member