



MAY 1 2003

TO: Thomas Scully
Administrator
Centers for Medicare and Medicaid Services

FROM: Dennis J. Duquette 
Acting Principal Deputy Inspector General

SUBJECT: Review of Rate Setting Methodology – Medicaid School-Based Child Health Program Costs Claimed by the Connecticut Department of Social Services (A-01-02-00006)

As part of the Office of Inspector General's self-initiated audit work, we are alerting you to the issuance within 5 business days of our final audit report entitled, "Review of Rate Setting Methodology – Medicaid School-Based Child Health Program Costs Claimed by the Connecticut Department of Social Services – July 1997 through June 2001." A copy of the report is attached. This report is one in a series of reports in our multi-state initiative focusing on costs claimed for Medicaid school-based health services.

The objective of the review was to determine if the methodologies used to develop the reimbursement rates used by the Connecticut Department of Social Services (State agency) for School-Based Child Health Program (SBCHP) services for the period July 1997 through June 2001 were reasonable and in accordance with applicable federal regulations.

The State agency developed the SBCHP reimbursement rates utilizing cost data from the seven largest local education agencies (LEA) in Connecticut. Our review showed that the rates were not developed in accordance with applicable federal cost allocation regulations or Centers for Medicare and Medicaid Services (CMS) program guidelines. Specifically, we found that: LEA indirect costs were not properly allocated in accordance with Office of Management and Budget (OMB) Circular A-87 standards; State Department of Education indirect costs were not supported by an approved indirect cost rate; and LEA transportation costs were not allocated in accordance with OMB Circular A-87 standards and Medicaid guidelines.

Based on our analysis, we believe that the monthly SBCHP treatment service rates in effect during our review period were overstated by at least 50 percent. We also identified significant overstatements in the SBCHP evaluation rates. Accordingly, we calculated the amount of questionable federal financial participation (FFP) to be about \$32.8 million for the period July 1, 1997 through June 30, 2001. This included a

retroactive adjustment of \$15.1 million FFP representing increases related to the finalized SBCHP reimbursement rates for the period under review.

We attribute the rate setting problems to the fact that the State agency did not utilize appropriate cost allocation methodology for developing the rates. We also found that the State agency did not establish adequate procedures to verify that the cost data submitted by the LEAs were allowable and allocable for reimbursement under the SBCHP.

We recommended the State agency:

- Refund to the Federal Government the retroactive adjustment originally claimed in the CMS-64 for the quarter ended June 30, 2002 that we calculated to be about \$15.1 million FFP and work with CMS to resolve the remainder of the questionable claim amount that we estimated to be about \$17.7 million FFP.
- Recompute the SBCHP rates using acceptable cost allocation methodology. The revised rates should be based on federal regulations for allowability, allocability, and reasonableness per OMB Circular A-87.
- Verify the cost data submitted by the LEAs to ensure the accuracy of the costs to be included in the rate determination and screen the costs to eliminate those costs that are unallowable for inclusion in the rate determination.

In its response to our draft report, the State agency disagreed with our recommendations for financial adjustments because the SBCHP rates were reviewed and approved by CMS. The response did not address the procedural recommendations. Although CMS reviewed and approved the State agency's general methodology used to develop the SBCHP rates, our detailed review of the cost factors used in the rate development found significant overstated costs that were not allocated in accordance with basic federal cost allocation standards. We believe that our recalculation of the SBCHP rates accurately reflected the extent of the overstatement of reimbursements made to the State agency. We continue to believe that financial adjustments are warranted. We also believe that our procedural recommendations should be implemented by the State agency in order to provide assurance that costs reported by the LEAs and used to develop future SBCHP rates are accurate and allowable for federal reimbursement.

We summarized the State agency's comments and responded to those comments at the conclusion of the FINDINGS AND RECOMMENDATIONS section, and included the comments in their entirety as the Appendix to the report.

Page 3 — Thomas Scully

Any questions or comments on any aspect of this memorandum are welcome. Please contact me or have your staff call George M. Reeb, Assistant Inspector General for the Centers for Medicare and Medicaid Audits at (410) 786-7104. To facilitate identification, please refer to report number A-01-02-00006 in all correspondence.

Attachment



MAY - 6 2003

Office of Audit Services
Region I
John F. Kennedy Federal Building
Boston, MA 02203
(617) 565-268

Report Number: A-01-02-00006

Ms. Patricia A. Wilson-Coker, Commissioner
Department of Social Services
State of Connecticut
25 Sigourney Street
Hartford, Connecticut 06106

Dear Ms. Wilson-Coker:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services report entitled, "Review of Rate Setting Methodology – Medicaid School-Based Child Health Program Costs Claimed by the Connecticut Department of Social Services – July 1997 through June 2001." A copy of this report will be forwarded to the action official named below for review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), Office of Inspector General, Office of Audit Services reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR part 5.)

To facilitate identification, please refer to report number A-01-02-00006 in all correspondence relating to this report.

Sincerely yours,

A handwritten signature in cursive script that reads "Michael J. Armstrong".

Michael J. Armstrong
Regional Inspector General
for Audit Services

Enclosures – as stated

Page 2 – Ms. Patricia A. Wilson-Coker

Direct Reply to HHS Action Official:

Dr. Charlotte Yeh
Regional Administrator
Centers for Medicare and Medicaid Services – Region I
Department of Health and Human Services
Room 2325, JFK Federal Building
Boston, Massachusetts 02203

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF RATE SETTING
METHODOLOGY MEDICAID
SCHOOL-BASED CHILD HEALTH
PROGRAM COSTS CLAIMED BY THE
CONNECTICUT DEPARTMENT OF
SOCIAL SERVICES JULY 1997
THROUGH JUNE 2001**



**JANET REHNQUIST
Inspector General**

**MAY 2003
A-01-02-00006**

EXECUTIVE SUMMARY

BACKGROUND

The Connecticut Department of Social Services (State agency) is responsible for administering the School-Based Child Health Program (SBCHP). The SBCHP services are reimbursable under the Medicaid program and are provided by or through a local education agency (LEA) to students with special health related service needs identified in their Individual Education Plan. The State agency used statewide bundled rates to reimburse providers of these Medicaid services. The rates were developed from cost data submitted by the seven largest LEAs. The State agency claimed Medicaid reimbursements of about \$64 million federal financial participation (FFP) for SBCHP services during the period July 1997 through June 2001, including a retroactive adjustment made in June 2002 related to the finalization of the SBCHP rates.

OBJECTIVE

The objective of our review was to determine if the methodologies used to develop the reimbursement rates used by the State agency for SBCHP services for the period July 1997 through June 2001 were reasonable and in accordance with applicable federal regulations.

SUMMARY RESULTS OF REVIEW

The State agency developed the SBCHP reimbursement rates utilizing cost data from the seven largest LEAs in Connecticut. Our review showed that the rates were not developed in accordance with applicable federal cost allocation regulations or Centers for Medicare and Medicaid Services' (CMS) program guidelines. Specifically, we found that:

- The LEA indirect costs were not properly allocated in accordance with Office of Management and Budget (OMB) Circular A-87 standards, resulting in SBCHP cost pools being overstated by an average of about \$24 million per year;
- State Department of Education indirect costs were not supported by an approved indirect cost rate resulting in SBCHP cost pools being overstated by an average of about \$3 million per year; and
- The LEA transportation costs were not allocated in accordance with OMB Circular A-87 standards and Medicaid guidelines resulting in SBCHP cost pools being overstated from \$380,000 to \$4.4 million per year.

Based on our analysis, we believe that the monthly SBCHP treatment service rates in effect during our review period were overstated by at least 50 percent. We also identified significant overstatements in the SBCHP evaluation rates. Accordingly, we calculated the amount of questionable FFP to be about \$32.8 million for the period July 1, 1997 through June 30, 2001. This included a retroactive adjustment of \$15.1 million FFP representing increases related to the finalized SBCHP reimbursement rates for the period under review.

We attribute the rate setting problems to the fact that the State agency did not utilize appropriate cost allocation methodology for developing the rates. We also found that the State agency did not establish adequate procedures to verify that the cost data submitted by the LEAs were allowable and allocable for reimbursement under the SBCHP.

RECOMMENDATIONS

We recommended the State agency:

- Refund to the Federal Government the entire value of the retroactive adjustment originally claimed in the CMS-64 for the quarter ended June 30, 2002 that we calculated to be about \$15.1 million FFP.
- Work with CMS to resolve the remainder of the questionable claim amount that we estimated to be about \$17.7 million FFP.
- Recompute the SBCHP rates using acceptable cost allocation methodology. The revised rates should be based on federal regulations for allowability, allocability, and reasonableness per OMB Circular A-87.
- Verify the cost data submitted by the LEAs to ensure the accuracy of the costs to be included in the rate determination.
- Screen the costs to eliminate those costs that are unallowable for inclusion in the rate determination and provide further guidance to the LEAs regarding the allowability of costs.

In a written response to the draft report dated January 27, 2003 (see Appendix), the State agency disagreed with our recommendations to make the financial adjustments based on our recalculation of the SBCHP rates. The State agency stated that the SBCHP rates used were reviewed and approved by CMS. The response did not address our procedural recommendations.

Although CMS reviewed and approved the State agency's general methodology used to develop the SBCHP rates, our detailed review of the cost factors used in the rate development found significant overstated costs that were not allocated in accordance with basic federal cost allocation standards. We believe that our recalculation of the rates accurately reflected the extent of the overstatement of reimbursements made by the State agency. Therefore, we continue to believe that financial adjustments are warranted. We also believe that our recommendations relative to procedural issues should be addressed by the State agency in order to provide assurance that costs reported by the LEAs and used to develop future SBCHP rates are accurate and allowable for federal reimbursement.

TABLE OF CONTENTS

	Page
INTRODUCTION	
BACKGROUND	1
OBJECTIVE, SCOPE, AND METHODOLOGY	2
FINDINGS AND RECOMMENDATIONS	3
CRITERIA FOR REIMBURSEMENT OF SBCHP SERVICES	4
LOCAL EDUCATION AGENCY INDIRECT COSTS	5
STATE DEPARTMENT OF EDUCATION INDIRECT COSTS	6
TRANSPORTATION COSTS	7
OIG/OAS RECALCULATION OF SBCHP RATES	7
CONCLUSION	8
STATE AGENCY ACTIONS	9
RECOMMENDATIONS	9
STATE AGENCY’S COMMENTS AND OIG’S RESPONSE	10
Appendix - Connecticut Department of Social Services Response to Draft Report	

INTRODUCTION

BACKGROUND

The Medicaid program was established by title XIX of the Social Security Act and is jointly funded by the federal and state governments to provide medical assistance to certain individuals and families with low income and resources. At the federal level, Medicaid is administered by the Centers for Medicare and Medicaid Services (CMS).

The Medicaid program, recognizing the important role school health services can play in a child's development, has supported school centered health care as an effective method of providing access to essential medical care to eligible children. In this regard, the Individuals with Disabilities Education Act (IDEA), authorized federal funding to states for programs that impact Medicaid payment for services provided in schools.

Under part B of IDEA, school districts must prepare an Individual Education Plan (IEP) for each child, which specifies all special education and "related services" needed by the child. The Medicaid program can pay for some of the "health related services" included in the IEP, if they are among the services specified in Medicaid law and included in the Medicaid state plan. Such payments are made under the School-Based Child Health Program (SBCHP). Examples of SBCHP services include: physical therapy, speech pathology, occupational therapy, psychological services, and medical screening and assessment.

In Connecticut, the Department of Social Services (State agency) is responsible for the overall administration of the SBCHP. The SBCHP services eligible for Medicaid reimbursement are provided by or through a local education agency (LEA) to students with special needs pursuant to the IEP. The LEAs are reimbursed by the State agency on the basis of statewide bundled rates. The bundled rates are all inclusive based on cost data reported by the seven largest LEAs and included costs related to direct services, support services, and other indirect costs associated with providing the SBCHP services. All costs claimed by the State agency are reimbursed at the federal medical assistance percentage rate of 50 percent. The State agency did not submit a separate claim for administrative cost associated with the SBCHP.

Reimbursements for SBCHP services may include: one evaluation per SBCHP recipient per year; standard monthly reimbursement rate for treatments that may include one or more services per month; and medical equipment as needed. Treatment services comprise the majority of SBCHP service claimed for federal financial participation (FFP) by the State agency. For fiscal years (FY) 1998 through 2001, the State agency reimbursed SBCHP services using an interim rate based on FY 1997 cost data. In October 2001, the rates were finalized for FYs 1998, 1999, and 2000, and a new interim rate was established for FY 2001.

OBJECTIVE, SCOPE, AND METHODOLOGY

We conducted our audit in accordance with generally accepted government auditing standards. The objective of our review was to determine if the methodology used to develop the reimbursement rates used by the State agency for SBCHP services for the period July 1997 through June 2001 were reasonable and in accordance with applicable federal regulations. Specifically, we determined whether the:

- State agency rates were computed in accordance with applicable federal regulations included in Office of Management and Budget (OMB) Circular A-87 and CMS requirements included in the 1997 *Medicaid and School Health: A Technical Assistance Guide* (CMS guide); and
- State agency effectively analyzed and verified the SBCHP cost submissions from the seven LEAs used to develop the SBCHP rates.

To accomplish our audit objective, we:

- Held discussions with various officials from CMS, the State agency, State Department of Education (SDE), and the various LEAs participating in the SBCHP rate determination process;
- Reviewed federal and state laws, regulations, and guidelines pertaining to the Medicaid program and special education services provided under the SBCHP program;
- Reviewed the policies and procedures of LEAs for identifying costs applicable to the SBCHP programs; and
- Examined statistically selected random samples of SBCHP paid claims reimbursed to the Bristol, Bridgeport, Hartford, Meriden, New Britain, New Haven, and Waterbury LEAs during the period July 1996 through June 1999 to verify the integrity of Connecticut Department of Administrative Services (DAS) computer files maintained for LEA billings for services provided. These files were used in our recalculations of the SBCHP rates for this period.

Our internal control review was limited to obtaining an understanding of the State agency's methodology used for developing the SBCHP rates and procedures in place to ensure that the rates were determined in accordance with applicable federal and state Medicaid program regulations.

Our review covered SBCHP service costs claimed during the period July 1997 through June 2001. During this period, the State agency claimed reimbursements totaling \$64 million FFP for SBCHP services provided by 37 school districts. This included a retroactive adjustment of about

\$15.1 million FFP in the CMS-64, Quarterly Statement of Expenditures for the Medical Assistance Program for the quarter ended June 30, 2002, related to the finalization of the SBCHP rates for the period under review.

Our field work was performed at the State agency's main office in Hartford, Connecticut and the Connecticut LEAs offices in Bristol, Bridgeport, Hartford, Meriden, New Britain, New Haven, and Waterbury.

FINDINGS AND RECOMMENDATIONS

The State agency developed the SBCHP reimbursement rates utilizing cost data from the seven largest LEAs in Connecticut. Our review found that the rates were not developed in accordance with applicable federal cost allocation regulations or CMS program guidelines. Specifically, we found that:

- The LEA indirect costs were not properly allocated in accordance with OMB Circular A-87 standards resulting in SBCHP cost pools being overstated by an average of about \$24 million per year;
- The SDE indirect costs were not supported by an approved indirect cost rate resulting in SBCHP cost pools being overstated by an average of about \$3 million per year; and
- The LEA transportation costs were not allocated in accordance with OMB Circular A-87 standards and Medicaid guidelines resulting in SBCHP cost pools being overstated from \$380,000 to \$4.4 million per year.

Based on our analysis, we believe that the monthly SBCHP treatment service rates in effect during our review period were overstated by at least 50 percent. We also identified significant overstatements in the SBCHP evaluation rates. Accordingly, we calculated the amount of questionable FFP claimed by the State agency to be about \$32.8 million for the period July 1, 1997 through June 30, 2001.

We attribute the rate setting problems to the fact that the State agency did not utilize appropriate cost allocation methodology for developing the rates. We also found that the State agency did not establish adequate procedures to verify that the cost data submitted by the LEAs were allowable and allocable for reimbursement under the SBCHP.

The following sections detail the results of our review.

CRITERIA FOR REIMBURSEMENT OF SBCHP SERVICES

Office of Management and Budget Circular A-87

The policy for the reimbursement of SBCHP services was based on provisions governing all federally funded programs administered by state and local governments. In this regard, OMB Circular A-87 established principles and standards to provide a uniform approach for determining allowable costs for federal awards carried out through grants, cost reimbursement contracts, and other agreements with state and local governments.

The OMB Circular A-87 stated:

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.

The OMB Circular A-87 also defined reasonable costs as:

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.

Medicaid and School Health: A Technical Assistance Guide

The CMS guide, dated August 1997, contains specific technical information on Medicaid requirements associated with payments for coverable services under the SBCHP. This CMS guide was provided to all state agencies for use in administering the SBCHP.

The CMS guide stated:

Once administrative activities are identified, costs must be...supported by a system which has the capability to properly identify and isolate the costs which are directly related to the support of the Medicaid program from all other costs incurred by the agency... and must abide by the cost allocation principles described in the Office of Management and Budget Circular A-87 which requires that costs be “necessary and reasonable” and “allocable” to the Medicaid program....

When claiming for allowable administrative activities that are performed with respect to a population consisting of both Medicaid-eligibles and non-eligibles, payment may only be made for the percentage of time actually attributable to the Medicaid-eligible individuals....

The CMS guide also provided guidance regarding the inclusion of transportation costs for the reimbursement of SBCHP services as follows:

...if a student with an IEP receives a Medicaid-covered service on school premises during the school day, the percentage of time spent receiving a Medicaid-covered services would be the same percentage reimbursed from the total cost of transportation to and from school...because this is the portion properly allocated to the receipt of the Medicaid-covered service.

LOCAL EDUCATION AGENCY INDIRECT COSTS

The State agency included LEA indirect costs in the SBCHP rates. The allocation of these costs was based on the LEA cost of operating the school district, including costs related to the superintendent and school principals' offices, maintenance and other operating costs of the school districts, costs related to building and land acquisitions, and debt service costs. The State agency determined the percentage of SBCHP students to total students in the LEAs' districts and applied the percentage to the indirect costs of the school districts.

We believe that this method did not account for the fact that the SBCHP student's normal school day includes regular education and non-SBCHP special education services, as well as SBCHP services. According to Medicaid regulations, funds are intended to reimburse LEAs for costs of providing health care services to eligible recipients and not for costs associated with their basic education. Thus, the rate setting process should recognize only those costs related to the provision of Medicaid eligible services. Consequently, we believe that an additional allocation step down is needed to account for only the time that an eligible recipient receives SBCHP services during the school day.

We utilized SBCHP billing records maintained by DAS, the billing coordinator for the SBCHP.¹ These billing records showed that the amount of SBCHP services actually provided to eligible recipients, in relation to the total available school instructional service time, amounted to 1.89 percent, 1.67 percent, and 1.64 percent for FYs 1997, 1998, and 1999, respectively. We applied these percentages to the LEA indirect costs related to SBCHP students to determine a reasonable allocation of LEA indirect costs related to actual SBCHP services provided to these students. Our calculations resulted in average decreases of about \$24 million per year in the amount of LEA indirect costs allocable to the SBCHP rate cost pool compared to the method used by the State agency as follows:

¹ Based on a random sample of LEA billings, we determined that the DAS files accurately accounted for LEA services provided to SBCHP recipients.

<u>FY</u>	<u>Allocation of LEA Indirect Costs</u>		<u>Difference</u>
	<u>Per State Agency</u>	<u>Per OIG/OAS</u>	
1997 *	\$22,357,072	\$422,549	\$21,934,523
1998	23,737,689	396,419	23,341,270
1999	28,698,091	470,649	28,227,442

* 1997 costs were used in determining rates for FYs 2000 and 2001.

We used the Office of Inspector General (OIG)/Office of Audit Services (OAS) allocation of LEA indirect costs in recomputing the SBCHP rates, the net results of which are included in the OIG/OAS RECALCULATION OF SBCHP RATES section of this report.

STATE DEPARTMENT OF EDUCATION INDIRECT COSTS

The SDE functions in an advisory role for the SBCHP in that it provides the State agency and LEAs information regarding the implications of Medicaid requirements in relation to educational requirements and practices of the school districts. The State agency included SDE indirect costs in the SBCHP rate development based on the application of a rate of 5.9 percent to total costs included in the cost pool. This resulted in the following costs included in the SBCHP rate cost pool:

<u>FY</u>	<u>SDE Indirect Costs</u>
1997	\$2,658,731
1998	3,058,751
1999	3,515,679

Documentation for the support of this rate was limited and use of the rate was not supported. Our discussions with State agency personnel found that the rate was apparently the approved indirect cost rate that was in effect for FY 1995 used by SDE in claiming costs under federally funded U.S. Department of Education (USDOE) grant awards.

We contacted the USDOE Indirect Cost Determination staff to discuss the applicability of this indirect cost rate for SBCHP rate setting purposes. According to the USDOE officials, this was not an appropriate use of the rate. They stated that this rate should only be used for those grants awarded to the SDE because the base used to develop the rate included only SDE costs. Consequently, we believe that the use of the SDE rate was inappropriate for SBCHP rate setting purposes because it was applied to LEA costs.

As a result, we excluded all SDE costs in our recomputation of the State agency's SBCHP rates. As noted above, these costs amounted to an average of about \$3 million per year for the period reviewed.

TRANSPORTATION COSTS

The State agency included an allocation of transportation costs to the SBCHP rate cost pool. This was based on the LEAs reported transportation costs related to students receiving SBCHP services. For FYs 1998 and 1999, the State agency further reduced these transportation costs by applying a factor of 8.33 percent to these costs. According to State agency officials, the adjustment was to reduce transportation costs to represent only those days in which SBCHP services were provided to these students. The basis for the 8.33 percent factor was not documented and could not be fully explained by State agency officials. A similar adjustment was not made to the FY 1997 cost data on which the FYs 2000 and 2001 rates were based. Instead, the entire cost of transportation related to the SBCHP students was used in the rate calculation for these years.

Although the State agency attempted to adjust costs to more accurately reflect those costs associated with SBCHP services in FYs 1998 and 1999, we believe that this methodology was not consistent with federal cost allocation standards. In this regard, we believe that the standards included in OMB Circular A-87 and the CMS guide should have been used to determine the equitable portion of the transportation costs that are allocable to the program. As previously noted, we determined that between 1.64 percent and 1.89 percent of the SBCHP recipient's time in school is related to receiving SBCHP services. We, therefore, applied these percentages to the transportation costs for purposes of revising the rate. Based on this, our calculations resulted in a decrease of the allocations for transportation costs of about \$380,000 to \$4.4 million per year compared to the State agency allocation for these costs as follows:

<u>FY</u>	<u>Transportation Costs</u>		<u>Difference</u>
	<u>Per State Agency</u>	<u>Per OIG/OAS</u>	
1997	\$4,522,633	\$85,478	\$4,437,155
1998	475,934	95,415	380,519
1999	505,941	99,609	406,332

We used the OIG/OAS transportation costs in our recalculations of the SBCHP rates.

OIG/OAS RECALCULATION OF SBCHP RATES

Based on our revisions to the allocation methodologies used for LEA and SDE indirect costs and transportation costs, we recalculated the SBCHP rates in effect for the period July 1997 through June 2001. We determined that the State agency's rates for SBCHP treatment services were overstated by over 50 percent as follows:

<u>FY</u>	<u>State Agency Final Treatment Rates</u>	<u>OIG/OAS Revised Treatment Rates</u>
1998	\$384	\$176
1999	433	190
2000	403	182
2001	425	188

Similarly, the State agency's rates for SBCHP evaluations were also significantly overstated as follows:

<u>FY</u>	<u>State Agency Final Evaluation Rates</u>	<u>OIG/OAS Revised Evaluation Rates</u>
1998	\$3,116	\$1,471
1999	3,834	1,729
2000	2,028	1,498
2001	2,400	1,549

The State agency rates for FYs 1998 and 1999 were based on actual LEA cost data for these years. The rates for FYs 2000 and 2001 were based on FY 1997 cost data, increased each year by the Consumer Price Index (CPI) inflation factors. Our revised rates are based on the same cost data, adjusted to consider the allocation methodology changes noted above, and also increased by the CPI inflation factors to determine the FYs 2000 and 2001 rates.

Based on our revised rates, we determined that the State agency claimed questionable title XIX reimbursements for SBCHP services as follows:

<u>FY</u>	<u>Overcharge Based on Interim Rate*</u>	<u>Overcharge Based on Retroactive Adjust.*</u>	<u>Total Overcharge*</u>
1998	\$ 3.8 million	\$ 3.1 million	\$ 6.9 million
1999	3.4	6.0	9.4
2000	4.9	2.0	6.9
2001	<u>5.6</u>	<u>4.0</u>	<u>9.6</u>
Total	\$17.7 million	\$15.1 million	\$32.8 million

* Represents FFP amount.

CONCLUSION

In summary, we believe that the rate setting methodology used by the State agency for developing the SBCHP rates did not adhere to OMB Circular A-87 standards or Medicaid

program guidelines for determining equitable allocations of costs. As a result, the rates used to reimburse LEAs for SBCHP services were overstated. We attribute the rate setting problems to the fact that the State agency did not utilize appropriate cost allocation methodology for establishing the SBCHP cost pool. In addition, the State agency provided little oversight for the compilation of cost data submitted by LEAs for the rate calculation and performed minimal verification of costs reported to actual supporting documentation. Our discussions with personnel from the various LEAs confirmed that the State agency provided little guidance on how to report cost data or what cost should be reported.

Based on our recalculation of the rates, utilizing OMB Circular A-87 cost allocation standards, we determined that the amount of questionable FFP claimed by the State agency was about \$32.8 million. Included in this claim is the retroactive adjustment of \$15.1 million FFP, representing the amount claimed by the State agency associated with the finalization of the interim rates that were in effect during the period July 1997 through June 2001.

STATE AGENCY ACTIONS

During the course of our review, we held a number of meetings with State agency and CMS personnel to discuss these audit findings. The State agency acknowledged that the SBCHP rate needs to be revised and they are currently working on developing a new methodology for establishing the SBCHP rates. Subsequent to the end of our audit field work, the State agency submitted, on October 2, 2002, a revised CMS-64 for the quarter ended June 30, 2002 that reduced the retroactive adjustment claim of \$15.1 million FFP to about \$7.5 million FFP. However, the State agency reserved the right to claim the remainder of the adjustment in future quarterly claim submissions to CMS.

RECOMMENDATIONS

We recommended the State agency:

- Refund to the Federal Government the entire value of the retroactive adjustment originally claimed in the CMS-64 for the quarter ended June 30, 2002 that we calculated to be about \$15.1 million FFP.
- Work with CMS to resolve the remainder of the questionable claim amount that we estimated to be about \$17.7 million FFP.
- Recompute the SBCHP rates using acceptable cost allocation methodology. The revised rates should be based on federal regulations for allowability, allocability, and reasonableness per OMB Circular A-87.
- Verify the cost data submitted by the LEAs to ensure the accuracy of the costs to be included in the rate determination.

- Screen the costs to eliminate those costs that are unallowable for inclusion in the rate determination and provide further guidance to the LEAs regarding the allowability of costs.

STATE AGENCY’S COMMENTS AND OIG’S RESPONSE

The State agency, in its written response to the draft report dated January 27, 2003 (see Appendix), disagreed with our recommendations to refund the retroactive adjustment claimed in the CMS-64 for the quarter ended June 30, 2002 as well as the remainder of the questionable costs identified in our report. However, the State agency recognized the need to change the SBCHP rate setting methodology. The following provides a summary of the State agency’s response and the OIG additional comments on the various issues included in the report.

State Agency’s Comments – General

The State’s letter maintained that since 1998 the State has acknowledged that changes were warranted to the rate setting methodology, but that CMS has been unwilling to consider such changes. The letter also quoted a May 21, 1999 directive from CMS to all State Medicaid Directors regarding bundled rates for school-based Medicaid services, which stated that “no retroactive disallowances of FFP are planned nor are prospective deferrals.”

OIG’s Response – General

We do not believe that CMS’s actions and statements regarding bundled rates are relevant to the OIG audit findings. Revisions to the bundled rate methodology, as reportedly contemplated by the State, would have had no effect on our findings regarding the failure to follow applicable cost principles in determining a correct allocation of actual costs. Moreover, the May 21, 1999 directive did not refer to disallowances for the improper application of a bundled rate methodology. Rather, CMS was assuring States that CMS would not impose disallowances based on a State’s failure to discontinue use of bundled rates and begin to charge on a fee-for-service basis, as was suggested by the directive.

State Agency’s Comments – LEA Indirect Costs

With respect to LEA indirect costs, the comments stated, “The audit suggests that the percentage of time students spend receiving Medicaid covered services during the school day should be used for LEA indirect cost allocation purposes....” The State agency noted that in performing our audit analysis of the rate, we used services time reported in Monthly Service Information Forms (MSIF) completed by the LEAs. The State agency contended that these forms are not reliable because “...the forms are filed only to assure that a student has received at least one Medicaid covered service during a month to qualify for a monthly bundled rate charge, we do not believe that it captures all direct medical service time for special education students.” The State agency believes that “...a more reasonable prospective change to the current LEA indirect cost

allocation would be to apply the ratio of total school-wide indirect to direct service/education costs to actual direct costs of providing Medicaid eligible medical services based upon school cost filings....”

OIG’s Response – LEA Indirect Costs

We reiterate the fact that the State agency’s method of allocating LEA indirect costs based on the straight percentage of SBCHP students to total student population in the LEA results in an inequitable allocation of costs. As noted in our report, this method does not take into account the fact that the primary service received by SBCHP students at the LEAs is regular education. Consequently, we utilized the MSIF to provide a means to identify the actual amount of SBCHP services received by these students to determine the portion of the students’ total school time associated with SBCHP services.

We determined that this data was reliable through discussions with personnel from the seven LEAs reviewed which indicated that, in fact, the forms included all direct SBCHP services provided to eligible students. As noted in our report, we also verified the accuracy of the data with the source records available at the LEAs. Consequently, we believe that the data obtained from these forms was accurate and complete as to the SBCHP services provided to the eligible students and provided for a valid basis for allocating the students’ time between regular education and SBCHP services. Additionally, we believe that this method of allocation complied with OMB Circular A-87 which required that costs be allocated in accordance with benefits received.

State Agency’s Comments – SDE Indirect Costs

With respect to the SDE indirect costs allocated to the SBCHP rate cost pool, the State agency noted that “...application of the 5.9% to LEA costs was disclosed and accepted by CMS....” However, for prospective rates, the State agency suggested that “...a portion of SDE special education administration costs be allocated to SBCH rates based upon the percentage of direct SBCH costs to total LEA special education costs.”

OIG’s Response – SDE Indirect Costs

The State agency’s comments to the issue of SDE allocated costs suggests that changes are needed in the manner in which these costs were allocated to the SBCHP rate. We agree and acknowledge that an allocation of some costs for the SDE may be appropriate. However, any method for allocating these costs would have to ensure that the costs are reasonable and also not included in funding provided by other federal sources, such as the USDOE. Based on the services now being provided by the SDE, i.e., an advisory role, we believe that the cost allocation would be minimal at best.

State Agency’s Comments – Transportation Costs

With regard to the allocation of transportation costs to the SBCHP rate cost pool, the State agency’s comments stated, “Transportation costs included in the final/interim replacement rates for 1997 were based on 60% of special education student transportation costs for individuals with transportation assistance identified in their IEP....” The percentage “...reflected the results of a 1994 review indicating that such students received SBCH covered services 3 out of 5 school days. This allocation was approved by CMS....”

OIG’s Response – Transportation Costs

With respect to the issue of LEA transportation costs, the State agency refers to a review done in 1994 indicating that SBCHP students receive SBCHP services on 60 percent of the days they attend school. Documentation to support the review was not made available. Further, the results of our prior review of SBCHP services, included in our report to the State agency dated May 9, 2002 (A-01-01-00006), showed that about 65 percent of the SBCHP recipients reviewed received 3 hours or less of SBCHP services per month. Based on our review results, we questioned the validity of the State agency’s 1994 review and the allocation of transportation costs.

As noted in our report, we believe that transportation costs should be allocated in accordance with standards included in OMB Circular A-87 and the CMS guide that required such cost be allocated in accordance with benefits received.

OIG’s Recalculation of SBCHP Rate Based on State Agency Alternatives

In its comments, the State agency agreed that prospective SBCHP rate setting changes were warranted. As noted above, they suggested various alternative methods for allocating LEA indirect costs and transportation costs. We do not agree that these alternative methods provide the most equitable allocations of costs for establishing the SBCHP rates. However, to determine the effect, we recalculated the SBCHP rates using the State agency’s suggested methods. The following illustrates a comparison of cost allocations using the amounts included in the State agency’s finalized SBCHP rates versus the State agency’s suggested alternative methods for the 1998 rate year:

<u>Cost Element</u>	<u>Finalized Allocation</u>	<u>Alternative Allocation</u>
LEA Indirect	\$23,712,329	\$6,868,002
Transportation	475,934	2,856,746

We found that recalculating the monthly reimbursement rates based on these alternative methods resulted in SBCHP rates that were considerably less than the finalized rates that were the basis of

the State agency's retroactive adjustment claimed in the CMS-64 for the quarter ended June 30, 2002, and also less than the original interim rates used to claim FFP. The following illustrates these differences:

<u>Type of Service</u>	<u>Interim Rates</u>	<u>Finalized Rates</u>	<u>Alternative Methods</u>
Treatments	\$ 320	\$ 384	\$ 284
Evaluations	2,100	3,116	1,946

We believe that (1) the State agency's acknowledgement that the SBCHP rates need to be revised and (2) the effect of the allocation methodologies suggested in their comments, as noted above, further justifies our conclusion that the State agency's claim for SBCHP reimbursement was overstated and warrants financial adjustments.

It is our opinion that the State agency has a responsibility to ensure the proper and efficient expenditure of federal funds. However, subsequent to our identification and disclosure to the State agency officials of the allocation problems that led to the overstated rates, the State agency still processed the adjustment finalizing the interim SBCHP rates. As noted above, the adjustments increased the final FY 1998 LEA reimbursements for treatment services from \$320 to \$384 and for evaluations from \$2,100 to \$3,116. Similar adjustments increased the final reimbursement rates for FYs 1999, 2000, and 2001. The adjusted rates were applied to LEA billings made during the period July 1997 through June 2001 and resulted in the retroactive adjustment of \$15.1 million claimed in the CMS-64 for the quarter ended June 30, 2002.

In summary, we believe that our recalculation of the SBCHP rates, as noted in our report, was accurate and in compliance with basic federal cost allocation regulations and CMS requirements. We reaffirm our conclusion that the State agency rates were significantly overstated. Therefore, we believe that the retroactive adjustment of \$15.1 million FFP was inappropriate and should be refunded to the Federal Government in its entirety. The additional \$17.7 million FFP claimed on the basis of the interim rates was also overstated and needs to be resolved with CMS. The State agency's comments did not address our recommendations relative to procedural changes for verifying LEA cost data or screening costs to eliminate potential unallowable costs from the rate determination. However, we believe that implementation of these recommendations will provide a basis for identifying accurate cost data for use in the development of future SBCHP rates.



STATE OF CONNECTICUT

DEPARTMENT OF SOCIAL SERVICES

25 SIGOURNEY STREET • HARTFORD, CONNECTICUT 06106-5033

Appendix
Page 1 of 6

January 27, 2003

Michael J. Armstrong
Regional Inspector General for Audit Services
Department of Health & Human Services
Office of Inspector General
Office of Audit Services, Region 1
John F. Kennedy Federal Building
Boston, Massachusetts 02203

Dear Mr. Armstrong:

We recently received a copy of a draft audit report prepared by your office entitled, "Review of Rate Setting Methodology Medicaid School Based Child Health Program Costs Claimed by Connecticut Department of Social Services July 1997 – June 2001 (CIN: A-01-02-00006)." The document recommends that CMS require the State of Connecticut to:

- Refund to the Federal government the entire value of the retroactive adjustment originally claimed in the June 2002 CMS-64, which has been calculated to be approximate \$15.1 million FFP. (\$7.5 million of the claim was deferred by CMS therefore recovery of the balance of \$7.6 million is recommended.)
- Work with CMS to resolve the remainder of the questionable claim amount. Which you estimate to be about \$17.7 million FFP.
- Re-compute the SBCHP rates using acceptable cost allocation methodology. The revised rates should be based on Federal regulations for allowability, allocability, and reasonableness per OMB A-87.
- Verify the cost data submitted by the LEAs to ensure the accuracy of the costs to be included in the rate determination.
- Screen the costs to eliminate those costs that are unallowable for inclusion in the rate determination and provide further guidance to the LEAs regarding the allowability of costs.

Mr. Armstrong
January 27, 2003
Page 2 of 6

Thank you for the opportunity to comment on the draft audit of School-Based Child Health (SBCH) claiming and rate-setting. Before addressing specific audit findings it is important that you be aware that we are particularly concerned with the recommendation to retroactively recover Federal cost sharing on Connecticut Medicaid claims associated with SBCH services between July 1, 1997 and June 30, 2001.

The SBCH rate-setting method, including local school overhead, Connecticut Department of Education percentage allocations and transportation costs, were reviewed and approved by CMS officials in 1995 when State Plan Amendment (SPA) 93-16 implemented bundled cost-based rates. SBCH services represent 1.5% of Connecticut Medicaid expenditures.

Annually since 1995, SBCH Medicaid rates have been reviewed with our on-site CMS representative prior to implementation. Also, the retroactive rate adjustments that were processed through our MMIS in July, 2002 for rate periods between July 1, 1997 and June 30, 2000 were reviewed prior to issuance. Since SBCH rates were reviewed and approved by CMS you can understand why we believe that any retroactive disallowances would be inappropriate.

Further, we have maintained since 1998 that prospective SBCH rate setting changes were warranted. In the fall of 1998 we initiated a project to improve the accuracy of SBCH rates through a thorough review of direct and indirect costs. Our consultants and Department staff met with CMS Boston staff and statisticians on the project. The Department, as well as, schools districts expended significant resources and time compiling necessary SBCH service and cost information.

By the spring of 1999, the Department was prepared to submit a SPA to revise SBCHS rate-setting. CMS Boston staff informed us that any proposed changes to Medicaid State Plans involving SBCH bundled rate-setting methodologies would not only be denied but also result in a rescission of the original approval of a bundled rate method. Consequently, we were left with no choice but to continue with the previously approved method pending direction from CMS.

In a May 21, 1999, directive from Sally K. Richardson of HCFA/CMS to State Medicaid Directors, CMS indicated that there were concerns across the country about bundled rates for SBCHS. The letter stated that, "...HCFA would like to work with states to

Mr. Armstrong
January 27, 2003
Page 3 of 6

implement a strategy so that States can come into compliance prospectively. At this time, no retroactive disallowances of FFP are planned nor are prospective deferrals. However, we expect states to work to come into compliance with this policy expeditiously." CMS did not follow-up with any further guidance and multiple efforts by DSS to meet with CMS representatives on the matter were unsuccessful.

Audit Findings & State Response

OIG Finding #1 – “LEA indirect costs were not properly allocated in accordance with OMB Circular A-87 standards resulting in SBCHP cost pools being overstated by an average of about \$24 million per year.”

State Response:

During the time period covered by the audit of SBCH claims, rates reflected indirect costs based upon the number of special education students receiving Medicaid covered services as a percentage of the total number of students in participating school systems. This method was reviewed and approved by CMS when bundled rates were adopted. Since approximately 10% of all students received rehabilitation services as part of their IEP, that percentage of school overhead costs has been allocated to annual SBCH rates.

The audit suggests that the percentage of time students spend receiving Medicaid covered services during the school day should be used for LEA indirect cost allocation purposes. In order to determine how much time of the school day that special education students receive medical services covered under SBCH, the auditors used service time reported in Monthly Service Information Forms (MSIF). The MSIFs are completed by the medical service professionals including speech and language pathologists, social workers, occupational and physical therapists and nurses. However, since the forms are filed only to assure that a student has received at least one Medicaid covered service during a month to qualify for a monthly bundled rate charge, we do not believe that it captures all direct medical service time for special education students.

The audit report cites, “Medicaid and School Health: A Technical Assistance Guide, 1997”, which states, “When claiming for allowable administrative activities that are performed with respect to a population consisting of both Medicaid-eligibles and non-eligibles, payment may only be made for the percentage of time actually attributable to the Medicaid-eligible individuals...” This quote appears on page 51 of the Guide in a section pertaining to General Administrative Services which, per the Guide, include Medicaid eligibility determinations, Medicaid outreach and case management activities not rate setting for SBCH medical services. It is unclear why the audit references this section.

Mr. Armstrong
January 27, 2003
Page 4 of 6

The Guide on page 34 in a section concerning SBCH service rate setting indicates that, " ... the state Medicaid agency may prefer to develop unique payment rates for school-based providers that more closely reflect the costs incurred by such providers, as long as those rates are consistent with efficiency, economy and quality of care." It further states that such rates should be approved by CMS (HCFA).

We would suggest that a reasonable prospective change to the current LEA indirect cost allocation would be to apply the ratio of total school-wide indirect to direct service/education costs to actual direct costs of providing Medicaid eligible medical services based upon school cost filings. For example, indirect costs represented approximately 30% of direct service/education costs in SFY 1998. Applying this percentage to direct SBCH costs in 1998 would have resulted in \$6.9 million in allocable indirect costs. A comparison of originally reported, OIG method and the new proposed indirect allocation is presented below. We believe that this methodology is consistent with both OMB Circular A-87 and the Medicaid and School Health: Technical Assistance Guide.

The following compares allowable indirect LEA costs using the current, OIG and indirect/direct methods.

Total Indirect Costs for Participating School Districts	LEA Indirect Costs (SFY 1998 Used For Comparison)		
	Amount in Issued Rates	OIG Approach	Indirect as % of Direct Costs
\$253,607,792	\$23,712,329	\$396,419	\$6,868,002

OIG Finding #2 – “State Department of Education (SDE) indirect costs were not supported by an approved indirect cost rate resulting in SBCHP cost pools being overstated by an average of about \$3 million per year.”

State Response:

As previously indicated, application of the 5.9% to LEA costs was disclosed and accepted by CMS. For prospective rates, we would suggest that a portion of SDE special education administration costs be allocated to SBCH rates based upon the percentage of direct LEA SBCH costs to total LEA special education costs.

Mr. Armstrong
January 27, 2003
Page 5 of 6

OIG Finding #3 – “LEA transportation costs were not allocated in accordance with OMB A-87 standards and Medicaid guidelines resulting in SBCHP cost pools being overstated from \$380,000 to \$4.4 million per year.”

State Response:

The recommended audit adjustment reflects the same allocation method as applied to indirect LEA costs in Finding #1. As previously stated, use of MSIF data is not reliable for cost allocation purposes.

Transportation costs included in final/interim replacement rates for 1997 were based on 60% of special education student transportation costs for individuals with transportation assistance identified in their IEP. The 60% reflected the results of a 1994 review indicating that such students received SBCH covered services 3 out of the 5 school days. This allocation was approved by CMS. Original interim rates for 1998 and 1999 also included this method, however, final/interim replacement rates for 1998 and 1999 were revised to include a smaller portion of transportation costs based upon discussions with the OIG auditors.

Per recent correspondence from CMS, it is now advised that SBCH rates reflect the direct cost of transporting the student to and from school for days that include the provision of a SBCH service. The following chart compares allowable transportation costs using the current, OIG and CMS new advised method.

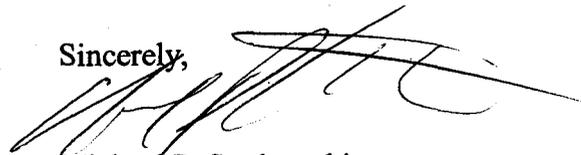
Transportation Costs (SFY 1998 Used For Comparison)		
Amount in Issued Rates	OIG Approach	CMS New Advised Method
\$475,934	\$95,415	\$2,856,746

Mr. Armstrong
January 27, 2003
Page 6 of 6

Connecticut has taken pride in its efforts to not only provide the linkage to crucial school based health services but to ensure that the systems are responsive and accountable. State agencies and local school systems have dedicated considerable resources and efforts in developing and maintaining these quality services. As we have also partnered with the federal government in these efforts, we have relied on the assistance and guidance from CMS. We appreciate the dedication and commitment of the CMS representatives and will continue to work on the process improvements as we strive to reach goals of raising the bar in children's health.

Please contact me should you have any questions regarding our responses to the audit (860-424-5053). Thank you for the opportunity to comment on the SBCH rate-setting report. We look forward to working with CMS on the ultimate resolution of any retroactive financial issues and prospective SBCH rate setting.

Sincerely,



Michael P. Starkowski
Deputy Commissioner

cc:

Marc Ryan, Secretary Office of Policy and Management
Patricia A. Wilson-Coker, Commissioner, Department of Social Services
David Parrella, Director, Medical Care Administration
Gary Richter, Director, Certificate of Need and Rate Setting
Lee Voghel, Director, Fiscal Analysis
Jim Wietrak, Director, Quality Assurance
Craig Zimmerman, Fiscal Administrative Manager