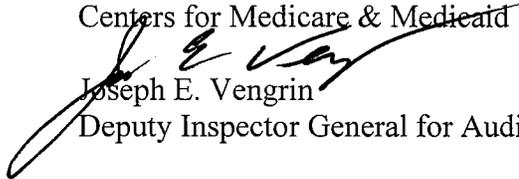




SEP - 8 2006

TO: Mark B. McClellan, M.D., Ph.D.
Administrator
Centers for Medicare & Medicaid Services

FROM: 
Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Medicaid School-Based Administrative Costs in Minnesota From July 1, 2003, Through June 30, 2004 (A-05-05-00040)

Attached is an advance copy of our final report on Medicaid school-based administrative costs in Minnesota. We will issue this report to the Minnesota Department of Human Services (the State agency) within 5 business days.

Our objective was to determine whether the State agency's Medicaid claims for certain school districts' school-based administrative costs were allowable in accordance with Federal and State requirements. The audit covered Medicaid claims for administrative costs incurred for State fiscal year (SFY) 2004, which ended June 30, 2004.

Of the \$26,852,175 (\$13,426,088 Federal share) claimed for the 60 school districts reviewed, \$7,373,175 (\$3,686,588 Federal share) was allowable and \$19,479,000 (\$9,739,500 Federal share) was unallowable in accordance with Federal requirements contained in the Office of Management and Budget Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments" and Centers for Medicare & Medicaid Services (CMS) guidance. In calculating its claims for Medicaid school-based administrative costs, the State agency made the following errors:

- For all 60 school districts, the State agency used county proportional Medicaid share ratios that included children and adults instead of children only, which resulted in overstated claims of \$19,479,030 (\$9,739,515 Federal share).
- For three school districts, the State agency included indirect costs that were allocable to other Federal non-Medicaid grants, which resulted in overstated claims of \$17,446 (\$8,723 Federal share).
- For three school districts, the State agency used cost reports that contained errors, omissions, and misstatements, which resulted in understated claims of \$17,476 (\$8,738 Federal share).

These errors occurred because the State agency (1) was unaware that its county proportional Medicaid share ratios did not comply with Federal requirements, (2) did not ensure that school

districts excluded from cost reports indirect costs allocable to other Federal non-Medicaid grants, and (3) had inadequate procedures for verifying the accuracy of school district cost report data.

We recommend that the State agency (1) refund \$9,739,500 to the Federal Government; (2) use proportional Medicaid share ratios that comply with Federal requirements to recalculate all SFY 2004 claims for the unaudited school districts, public health agencies, and correction agencies and refund any differences; (3) require school districts, public health agencies, and correction agencies to report indirect costs in accordance with Federal requirements; and (4) develop procedures to verify the accuracy of cost report data submitted by school districts, public health agencies, and correction agencies.

In its comments on the draft report, the State agency agreed that costs may be allocated only to the extent that they relate to Medicaid-eligible children and said that it had changed its allocation formula to be consistent with the expectations in the CMS guidance. However, the State agency did not agree to refund the \$9,739,500, along with an unspecified amount related to unaudited agencies, or to implement our other recommendations. After reviewing the State agency's comments, we continue to believe that the State agency should comply with our recommendations.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at George.Reeb@oig.hhs.gov. Please refer to report number A-05-05-00040.

Attachment



DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF AUDIT SERVICES
233 NORTH MICHIGAN AVENUE
CHICAGO, ILLINOIS 60601

REGION V
OFFICE OF
INSPECTOR GENERAL

SEP 12 2006

Report Number: A-05-05-00040

Mr. Cal Ludeman
Commissioner
Minnesota Department of Human Services
P.O. Box 64998
St. Paul, Minnesota 55164-0998

Dear Mr. Ludeman:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Medicaid School-Based Administrative Costs in Minnesota From July 1, 2003, Through June 30, 2004." A copy of this report will be forwarded to the HHS action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS 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), OIG reports issued to the Department's grantees and contractors are made available to the public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

Please refer to report number A-05-05-00040 in all correspondence.

Sincerely yours,

A handwritten signature in cursive script that reads "Paul Swanson".

Paul Swanson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Ms. Jackie Garner
Regional Administrator
Centers for Medicare & Medicaid Services – Region V
233 North Michigan Avenue
Suite 600
Chicago, Illinois 60601

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICAID
SCHOOL-BASED
ADMINISTRATIVE COSTS
IN MINNESOTA
FROM JULY 1, 2003,
THROUGH JUNE 30, 2004**



Daniel R. Levinson
Inspector General

September 2006
A-05-05-00040

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. Specifically, these evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness in departmental programs. To promote impact, the reports also present practical recommendations for improving program operations.

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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 are made available to members of the public to the extent the information is not subject to exemptions in the act. (See 45 CFR part 5.)

OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Title XIX of the Social Security Act established the Medicaid program to pay medical assistance costs for certain individuals and families with limited incomes and resources. Each State administers its Medicaid program in accordance with a State plan approved by the Centers for Medicare & Medicaid Services (CMS). The Federal Government and the States share the cost of the program.

States may be reimbursed for administrative costs associated with Medicaid school-based health services provided under Part B of the Individuals with Disabilities Education Act. Medicaid school-based administrative activities include outreach, facilitation of eligibility determinations, information and referral services, health service coordination and monitoring, and interagency coordination. Because both non-Medicaid and Medicaid-eligible students receive these services, the service costs must be allocated between both groups. States use timestudies and other methods to determine the percentage of administrative costs allocable to Medicaid-eligible students and must develop and apply a proportional Medicaid share ratio to ensure that they claim only costs related to Medicaid-eligible children.

With CMS approval, the Minnesota Department of Human Services (the State agency) began claiming Medicaid school-based administrative costs in 1995 using its Local Collaborative Time Study. The State agency uses this random moment timestudy to statistically measure the time that staff of school districts, public health agencies, and correction agencies spend on Medicaid administrative activities. The State agency then applies the timestudy results and proportional Medicaid share ratios to cost reports received from these agencies and claims Federal reimbursement at 50 percent of the costs.

During State fiscal year (SFY) 2004, which ended June 30, 2004, the State agency claimed a total of \$44.9 million (\$22.5 million Federal share) in Medicaid school-based administrative costs incurred by 340 school districts, 69 public health agencies, and 74 correction agencies. The 340 school districts accounted for \$39.8 million (\$19.9 million Federal share), or 89 percent of the total. For the 60 school districts that we reviewed, which reported the highest Medicaid costs, the State agency claimed \$26.8 million (\$13.4 million Federal share).

OBJECTIVE

Our objective was to determine whether the State agency's Medicaid claims for certain school districts' school-based administrative costs were allowable in accordance with Federal and State requirements.

SUMMARY OF FINDINGS

Of the \$26,852,175 (\$13,426,088 Federal share) claimed for the 60 school districts reviewed, \$7,373,175 (\$3,686,588 Federal share) was allowable and \$19,479,000 (\$9,739,500 Federal

share) was unallowable. In calculating its claims for Medicaid school-based administrative costs, the State agency made the following errors:

- For all 60 school districts, the State agency used county proportional Medicaid share ratios that included children and adults instead of children only, which resulted in overstated claims of \$19,479,030 (\$9,739,515 Federal share).
- For three school districts, the State agency included indirect costs that were allocable to other Federal non-Medicaid grants, which resulted in overstated claims of \$17,446 (\$8,723 Federal share).
- For three school districts, the State agency used cost reports that contained errors, omissions, and misstatements, which resulted in understated claims of \$17,476 (\$8,738 Federal share).

These errors occurred because the State agency:

- was unaware that its county proportional Medicaid share ratios did not comply with Federal requirements,
- did not ensure that school districts excluded from cost reports indirect costs allocable to other Federal non-Medicaid grants, and
- had inadequate procedures for verifying the accuracy of school district cost report data.

RECOMMENDATIONS

We recommend that the State agency:

- refund \$9,739,500 to the Federal Government;
- use proportional Medicaid share ratios that comply with Federal requirements to recalculate all SFY 2004 claims for the unaudited school districts, public health agencies, and correction agencies and refund any differences;
- require school districts, public health agencies, and correction agencies to report indirect costs in accordance with Federal requirements; and
- develop procedures to verify the accuracy of cost report data submitted by school districts, public health agencies, and correction agencies.

STATE AGENCY'S COMMENTS

The State agency agreed that costs may be allocated only to the extent that they relate to Medicaid-eligible children and said that it had changed its allocation formula to be consistent

with the expectations in the CMS guidance. However, the State agency did not agree to refund the \$9,739,500, along with an unspecified amount related to unaudited agencies, or to implement our other recommendations. The State agency's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

After reviewing the State agency's comments, we continue to believe that the State agency should comply with our recommendations.

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INTRODUCTION

BACKGROUND

Medicaid Program

Title XIX of the Social Security Act established the Medicaid program to pay medical assistance costs for certain individuals and families with limited incomes and resources. Each State administers its Medicaid program in accordance with a State plan approved by the Centers for Medicare & Medicaid Services (CMS). The Federal Government and the States share the cost of the program.

Medicaid School-Based Services

States may be reimbursed for administrative costs associated with Medicaid school-based health services provided under Part B of the Individuals with Disabilities Education Act. Medicaid school-based administrative activities include outreach, facilitation of eligibility determinations, information and referral services, health service coordination and monitoring, and interagency coordination. Because both non-Medicaid and Medicaid-eligible students receive these services, the service costs must be allocated between both groups. States use timestudies and other methods to determine the percentage of administrative costs allocable to Medicaid-eligible students and must develop and apply a proportional Medicaid share ratio to ensure that they claim only costs related to Medicaid-eligible children.

According to Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," Attachment A, section C, allowable costs incurred under Federal awards must be reasonable, adequately supported, and allocable. A cost is allocable if the services involved are assignable to a cost objective in accordance with the relative benefits received. CMS issued a final guide in May 2003, "Medicaid School-Based Administrative Claiming Guide" (CMS final guide), to provide State Medicaid agencies, schools, and other interested parties with appropriate methods for claiming Federal reimbursement. CMS required all States' school-based administrative claiming programs to comply with the guide's provisions by October 2003. Before issuing the final guide, CMS issued draft guides for comments in February 2000 and November 2002.

Minnesota's Medicaid Administrative Claiming

With CMS's approval, the Minnesota Department of Human Services (the State agency) began claiming Medicaid school-based administrative costs in 1995 using its Local Collaborative Time Study (timestudy). The State agency uses this random moment timestudy to statistically measure the time that staff of school districts, public health agencies, and correction agencies spend on Medicaid administrative activities. The State agency then applies the timestudy results to cost reports received from these agencies to identify allocable Medicaid costs by activity. For those administrative activities provided to both non-Medicaid and Medicaid-eligible students, the State

agency develops and applies a proportional Medicaid share ratio to allocate the costs. The State agency applies the timestudy results and proportional Medicaid share ratios to the agencies' cost reports and claims Federal reimbursement at 50 percent of the costs. Through a contract with the State agency, each county acts as a fiscal reporting and payment agent to ensure that the participating agencies submit accurate and timely cost reports.

During State fiscal year (SFY) 2004, which ended June 30, 2004, the State agency claimed a total of \$44,910,462 (\$22,455,231 Federal share) in Medicaid school-based administrative costs incurred by 340 school districts, 69 county public health agencies, and 74 correction agencies. The 340 school districts accounted for \$39,770,262 (\$19,885,132 Federal share), or 89 percent of the total.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the State agency's Medicaid claims for certain school districts' school-based administrative costs were allowable in accordance with Federal and State requirements.

Scope

We limited our review to the 60 school districts with the highest Medicaid school-based administrative costs reported for SFY 2004. For these school districts, the State agency claimed \$26,852,175 (\$13,426,088 Federal share), which represented 67.5 percent of the total Federal reimbursement received for the 340 school districts.

We limited our review of internal controls to understanding the State agency's policies and procedures for reporting and claiming Medicaid school-based administrative costs incurred by school districts, public health agencies, and correction agencies. Specifically, we reviewed the policies and procedures that (1) all agencies followed in reporting incurred Medicaid costs and (2) the State agency used to calculate its claims for Federal reimbursement. We determined that the State agency calculated its claims using the same procedures for all agencies. In addition, we analyzed internal controls at 3 of the 60 school districts and their related counties to ensure the accuracy of the costs reported.

We also performed a limited review of the timestudy to understand (1) which administrative activities were allowable for Federal Medicaid reimbursement and (2) how the State agency used the timestudy results to determine allowable Medicaid school-based costs.

We performed fieldwork at the State agency; the county offices of Anoka, Blue Earth, and Waseca; and the school district offices of Anoka-Hennepin, Mankato, and Waseca from April through September 2005.

Methodology

To accomplish our audit objective, we:

- reviewed OMB Circular A-87, the CMS final guide, and timestudy guidelines;
- interviewed State agency, county, and school district personnel to understand the timestudy and the internal controls used to ensure that costs were reported and claimed in compliance with Federal and State agency policies;
- evaluated how the State agency conducted the timestudy, compiled the responses, and applied the results to determine allocable Medicaid activity costs;
- reviewed the Forms CMS-64, “Quarterly Medicaid Statement of Expenditures for the Medical Assistance Program,” to determine the Medicaid school-based costs claimed for SFY 2004;
- reviewed the three school districts’ SFY 2004 cost reports to determine their accuracy and reliability;
- obtained July 2003 U.S. Census Bureau population and State Medicaid enrollment data by county for children aged 5 to 19 years to recalculate the proportional Medicaid share ratios; and
- evaluated and recalculated the Federal share of costs claimed for the 60 school districts.

We performed our audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Of the \$26,852,175 (\$13,426,088 Federal share) claimed for the 60 school districts reviewed, \$7,373,175 (\$3,686,588 Federal share) was allowable and \$19,479,000 (\$9,739,500 Federal share) was unallowable. In calculating its claims for Medicaid school-based administrative costs, the State agency made the following errors:

- For all 60 school districts, the State agency used county proportional Medicaid share ratios that included children and adults instead of children only, which resulted in overstated claims of \$19,479,030 (\$9,739,515 Federal share).
- For three school districts, the State agency included indirect costs that were allocable to other Federal non-Medicaid grants, which resulted in overstated claims of \$17,446 (\$8,723 Federal share).

- For three school districts, the State agency used cost reports that contained errors, omissions, and misstatements, which resulted in understated claims of \$17,476 (\$8,738 Federal share).

These errors occurred because the State agency:

- was unaware that its county proportional Medicaid share ratios did not comply with Federal requirements,
- did not ensure that school districts excluded from cost reports indirect costs allocable to other Federal non-Medicaid grants, and
- had inadequate procedures for verifying the accuracy of school district cost report data.

CHILD AND ADULT STATISTICS IN MEDICAID SHARE RATIOS

The State agency used county proportional Medicaid share ratios that included Medicaid children and adults, rather than children only. The use of these ratios was in conflict with OMB Circular A-87 requirements as well as guidance provided by CMS. CMS requires that proportional Medicaid share ratios represent only Medicaid-eligible children. By including adult statistics, the State agency overstated the ratios by an average of 57 percent. As a result, the State agency made overstated claims totaling \$19,479,030 (\$9,739,515 Federal share). The State agency claimed these unallowable costs because, until November 2004, it was unaware that its proportional Medicaid share ratios did not meet Federal requirements.

Federal Requirements and Guidance

OMB Circular A-87, Attachment A, section C, requires allowable costs incurred by State and local governments in administering Federal awards to be reasonable, adequately documented, and allocable. Section C.3.a states: “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.” This means that States may claim as school-based administrative costs only the costs related to Medicaid-eligible children.

The May 2003 CMS final guide, effective October 1, 2003, clarifies the methodology for allocating administrative costs for activities provided to both Medicaid and non-Medicaid-eligible students. The guide states:

Since many school-based medical activities are provided to both Medicaid and non-Medicaid eligible students, the costs applicable to these activities must be allocated to both groups. This allocation of costs involves the determination and application of the proportional share of Medicaid students to the total number of students. Development of the proportional Medicaid share, which is sometimes referred to as the Medicaid eligibility rate, Medicaid percentage, allocable share or discount rate, should relate to and be based on the claiming unit (the entity submitting the claim).

For example, claims may be developed on the basis of an individual school, a school district, or a specific unit of government, such as a county or statewide, as determined by the claiming unit This process is necessary to ensure that only the costs related to Medicaid eligible children are claimed to Medicaid.

To establish the proportional Medicaid share, the number of Medicaid eligible students must be determined for each school/school district or governmental unit that is submitting a claim. This number serves as the numerator in a fraction, with the denominator being the total number of students in the same entity. This fractional value is then applied to the total costs applicable to the proportional Medicaid share time codes to determine the costs applicable to Medicaid administrative activities.

Overstated Proportional Medicaid Share Ratios

The State agency overstated its proportional Medicaid share ratios for the 60 school districts. The State agency developed and applied county ratios that ranged from 29 to 94 percent. The State agency based these ratios on Medicaid-eligible child and adult statistics derived from a State-administered county Social Service Time Study that was unrelated to the school-based administrative timestudy.¹ In contrast, we used July 1, 2003, U.S. Census Bureau population and State Medicaid enrollment data by county for children aged 5 to 19 years to calculate ratios that ranged from 7 to 40 percent. By including adult statistics, the State agency overstated the proportional Medicaid share ratios by an average of 57 percent, which resulted in overstated claims totaling \$19,479,030 (\$9,739,515 Federal share). (See the table below.)

Difference in Calculated Medicaid Share Ratios

	<u>Lowest Ratio</u>	<u>Highest Ratio</u>	<u>Average</u>
State agency ratios	29%	94%	76%
Auditor ratios	7%	40%	19%
Difference			<u>57%</u>

The State agency used the same county Social Service Time Study to identify proportional Medicaid share ratios for the 280 other school districts, 69 public health agencies, and 74 correction agencies not reviewed during this audit.

State Agency Unaware That Ratios Did Not Meet Federal Requirements

The State agency was unaware that its ratios did not meet OMB Circular A-87 requirements. However, it recognized its noncompliance with the CMS draft and final guide, which specified that proportional Medicaid share ratios must exclude activity costs that do not benefit Medicaid-eligible school children. In November 2004, 13 months after CMS required compliance with the

¹The Social Service Time Study was designed to ensure the proper distribution of county social service costs among the Federal funding sources that supported social service programs.

final guide, the State agency notified CMS that its claiming process did not meet the guide's provisions. The State agency planned to change its claiming process for allocating Medicaid costs after July 1, 2005. CMS did not respond to the State agency or request corrective action to refund improperly claimed Federal reimbursement.

UNALLOWABLE INDIRECT COSTS

The State agency claimed unallowable indirect costs for three school districts, which resulted in overstated claims of \$17,446 (\$8,723 Federal share). Although the school districts excluded from their cost reports direct costs allocable to other Federal non-Medicaid grants, they did not remove the associated indirect costs. The school districts improperly reported these indirect costs because personnel did not understand the State agency instructions for offsetting costs allocable to other Federal non-Medicaid grants.

Federal Requirements

OMB Circular A-87, Attachment A, section C, paragraph 3.c, states: "Any cost allocable to a particular Federal award or cost objective under the principles provided in this Circular 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."

According to the CMS final guide:

Certain revenues must offset allocation costs in order to reduce the total amount of costs in which the Federal government will participate. To the extent the funding sources have paid or would pay for the costs at issue, federal Medicaid funding is not available and the costs must be removed from total costs

Accordingly, direct costs and associated indirect costs allocable to other Federal non-Medicaid grants should not be claimed.

Indirect Costs Allocable to Other Federal Awards

The three school districts reported indirect costs related to other Federal programs totaling \$235,881 for SFY 2004, which caused the State agency to overstate its allocated Medicaid claims by \$17,446 (\$8,723 Federal share). The school districts included these costs because staff misunderstood the State agency instructions for removing indirect costs allocable to other Federal grants.

INACCURATE COST REPORTS

The State agency used inaccurate cost reports for three school districts, which resulted in understated claims of \$17,476 (\$8,738 Federal share). Two school districts overstated and one school district understated Medicaid costs. The State agency used the inaccurate cost reports

because the State agency's and county fiscal agents' cost report verification procedures were inadequate to ensure the reports' accuracy.

Federal Requirements

OMB Circular A-87, Attachment A, section C, requires allowable costs incurred by State and local governments in administering Federal awards to be reasonable, adequately documented, and allocable. The CMS final guide states: "In accordance with the statute, the regulations, and the Medicaid state plan, the state is required to maintain/retain adequate source documentation to support the Medicaid payments for administrative claiming." The State agency is responsible for ensuring that applicable policies are applied uniformly throughout the State and that claims submitted to CMS comply with such requirements.

Misstated Medicaid Costs

The three school districts misstated their cost pools, which resulted in a net understatement of \$767,085. Consequently, the State agency understated its allocated Medicaid claim by \$17,476 (\$8,738 Federal share). A review of the three school district cost reports disclosed that:

- The Mankato school district omitted fringe benefit costs, which understated its cost pools by \$1,269,472.
- The Anoka-Hennepin school district misstated salaries and fringe benefit costs, which overstated its cost pools by \$356,897.
- The Waseca school district inaccurately estimated and reported costs, which overstated its cost pools by \$145,490.

These misstatements occurred because the State agency's and county fiscal agents' cost report verification procedures were inadequate to ensure the reports' accuracy. Specifically, the State agency and county fiscal agents did not review or test the supporting documentation.

RECOMMENDATIONS

We recommend that the State agency:

- refund \$9,739,500 to the Federal Government;
- use proportional Medicaid share ratios that comply with Federal requirements to recalculate all SFY 2004 claims for the unaudited school districts, public health agencies, and correction agencies and refund any differences;
- require school districts, public health agencies, and correction agencies to report indirect costs in accordance with Federal requirements; and

- develop procedures to verify the accuracy of cost report data submitted by school districts, public health agencies, and correction agencies.

STATE AGENCY'S COMMENTS AND OFFICE OF INSPECTOR GENERAL'S RESPONSE

The State agency's comments are included in their entirety as Appendix B and are summarized below.

Child and Adult Statistics in Medicaid Share Ratios

State Agency's Comments

The State agency agreed that costs may be allocated only to the extent that they relate to Medicaid-eligible children and said that it had changed its allocation formula to be consistent with the expectations in the CMS final guide. However, the State agency did not agree to refund the \$9,739,500, along with an unspecified amount related to unaudited agencies, because it believed that CMS tacitly approved Minnesota's delay in complying with the CMS final guide by October 2003. The State agency asserted that CMS approved its claiming process in 1995 and did not respond to its implementation plan, proposed in accordance with the CMS final guide. The State agency further asserted that CMS does not have the authority to exclude other ratios by issuing "guidance" to States and that regulations, OMB Circular A-87, and the accompanying instructions do not dictate a specific allocation ratio. The State agency believed that because the CMS final guide was not in effect until October 1, 2003, the overpayment finding for the period July 1 through September 30, 2003, was inappropriate. The State agency also believed that the CMS final guide does not have the force and effect of law and that OMB Circular A-87 provides only that costs must be "allocable" to Medicaid.

The State agency said that if it revised the proportional Medicaid share ratios for SFY 2004, the ratios would increase, and CMS would owe Minnesota an additional \$290,965.

Office of Inspector General's Response

The State agency's allocation formula did not comply with (1) OMB Circular A-87, which existed prior to the CMS draft and final guides, and (2) the CMS final guide, which represented a compilation of existing policies under authority of current law, regulations, and guidance contained in OMB circulars. OMB Circular A-87, section C.3.a, states: "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" [emphasis added]. The Medicaid program received benefits relative to administrative services associated with providing Medicaid school-based health services to Medicaid-eligible children, not adults. However, the State agency used proportional Medicaid share ratios that included statistics for both Medicaid-eligible children and adults. As our finding states, the inclusion of adults in the allocation base increased school-based service costs beyond the benefits that Medicaid received. Because OMB Circular A-87 predates both the CMS draft and final guides and prohibits the inclusion of adults in the allocation base, we continue to believe that the State agency was overpaid from July 1 through

September 30, 2003. We continue to believe that the State agency should refund the \$9,739,500; recalculate all SFY 2004 claims for the unaudited school districts, public health agencies, and correction agencies; and refund any additional differences.

Because the proportional Medicaid share ratios decreased when we used children-only data for the 60 school districts reviewed, we concluded that the State agency overstated its claims. The State agency did not dispute the facts or the method that we used to recalculate its claims and did not include any information indicating how the revised ratios would actually increase the amount that CMS would owe Minnesota.

Unallowable Indirect Costs

State Agency's Comments

The State agency believed that it appropriately followed Federal guidance by applying indirect cost rates assigned by the Department of Education to the total direct salaries for the three school districts and disagreed that it claimed unallowable indirect costs. The State agency said that it totaled all applicable non-Medicaid costs, including payroll, indirect costs, and other direct costs, and offset those costs by applicable revenue to reduce the total costs in which Medicaid would participate.

Office of Inspector General's Response

We agree that the State agency used indirect cost rates assigned by the Department of Education, but we believe that the agency applied those rates to costs that were allocable to non-Medicaid programs. Although the school districts excluded direct costs allocable to other Federal non-Medicaid grants from their cost reports, they did not remove the associated indirect costs. Consequently, the State agency claimed Medicaid indirect costs for costs allocable to other programs. We continue to believe that the school districts, public health agencies, and correction agencies should report indirect costs in accordance with Federal requirements.

Inaccurate Cost Reports

State Agency's Comments

The State agency believed that its procedures were sufficient to verify the accuracy of 1,360 cost reports submitted annually by local government partners within a reasonable margin of error.

Office of Inspector General's Response

The State agency's procedures did not ensure the accuracy of the cost reports. Neither the State agency nor the county fiscal agents compared the reported costs to supporting documentation. We continue to believe that the State agency should develop procedures to verify the accuracy of cost report data submitted by school districts, public health agencies, and correction agencies.

APPENDIXES

APPENDIX A

SAMPLED INDEPENDENT SCHOOL DISTRICTS BY COUNTY

County	Sampled Independent School District(s)
Anoka County	Anoka-Hennepin Independent School District (ISD) #0011, Centennial ISD #0012, Forest Lake ISD #0831, Fridley Schools ISD #0014, Spring Lake Park ISD #0016, St. Francis ISD #0015
Beltrami County	Bemidji Area Schools ISD #0031, BRIC ISD #0998
Blue Earth County	Mankato ISD #0077
Carlton County	Cloquet Schools ISD #0094
Carver County	Carver-Scott Educational Coop. ISD #0930, Chaska Schools ISD #0112
Chippewa County	Montevideo ISD #0129
Chisago County	Chisago Lakes Area Schools ISD #2144
Clay County	Moorhead Schools ISD #0152
Crow Wing County	Brainerd Schools ISD #0181
Dakota County	Burnsville-Eagan-Savage ISD #0191, Inver Grove Heights ISD #0199, Lakeville Schools ISD #0194, Rosemount-Apple Valley-Eagan ISD #0196
Douglas County	Alexandria ISD #0206
Faribault/Martin County	Southern Plains Ed. Coop. ISD #0915
Freeborn County	Albert Lea ISD #0241
Hennepin County	Bloomington Schools ISD #0271, Eden Prairie School District ISD #0272, Edina Public Schools ISD #0273, Hopkins School Dist ISD #0270, Intermediate School District ISD #0287, Minneapolis Public Schools ISD #0001, Minnetonka Schools ISD #0276, Osseo School District ISD #0279, Robbinsdale Public Schools ISD #0281, Wayzata Schools ISD #0284
Isanti County	Cambridge-Isanti ISD #0911
Itasca County	Grand Rapids ISD #0318
Kandiyohi County	Willmar ISD #0347
Mower County	Austin Schools ISD #0492
Nobles County	Worthington ISD #0518
Olmsted County	Rochester ISD #0535
Otter Tail County	Fergus Falls Schools ISD #0544
Ramsey County	Mounds View ISD #0621, N. St. Paul-Maplewood-Oakdale ISD #0622, Roseville Area Schools ISD #0623, St. Paul Schools ISD #0625, White Bear Lake ISD #0624
Rice County	Faribault Public Schools ISD #0656
Scott County	Shakopee Schools ISD #0720
Sherburne County	Big Lake School District ISD #0727
St. Louis County	Duluth ISD #0709, Hermantown Community Schools ISD #0700, Hibbing ISD #0701, St. Louis County Schools ISD #2142
Stearns County	St. Cloud Schools ISD #0742
Steele County	Owatonna Public Schools ISD #0761
Waseca County	Waseca Schools ISD #0829
Washington County	S. Washington County Schools ISD #0833, Stillwater Area Schools ISD #0834
Winona County	Winona Schools ISD #0861
Wright County	Buffalo-Hanover-Montrose ISD #0877, Elk River Area Schools ISD #0728



Minnesota Department of **Human Services**

July 21, 2006

Mr. Paul Swanson
Regional Inspector General for Audit services
Department of Health and Human Services
Office of Audit Services
233 North Michigan Avenue
Chicago, Illinois 60601

Dear Mr. Swanson:

Thank you for the opportunity to review and comment on your draft audit report entitled "Review of Medicaid School-Based Administrative Costs in Minnesota from July 1, 2003, Through June 30, 2004."

In the draft report, you make the following findings and recommendations:

- 1. Allocation ratios.** For the 60 school districts included in the audit, the report states that we used county proportional Medicaid share ratios that included children and adults, instead of children only, which resulted in overstated claims of \$19,479,030 (\$9,739,515 Federal share). You recommend a refund of that \$9.7 million to the federal government, and recommend that we recalculate claims for the un-audited school districts, public health agencies, and correction agencies and refund any difference.
- 2. Indirect costs.** For three school districts, the draft provides that we included indirect costs that were allocable to other Federal non-Medicaid grants, which resulted in overstated claims of \$17,446 (\$8,723 Federal share). You recommend that we require school districts, public health agencies, and correction agencies to report indirect costs in accordance with federal requirements.
- 3. Cost reports.** For three school districts, the report states that we used cost reports that contained errors, omissions, and misstatements, which resulted in understated claims of \$17,476 (\$8,738 Federal share). You recommend that we develop procedures to verify the accuracy of cost report data submitted by school districts, public health agencies, and correction agencies.

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Minnesota Response

Minnesota shares with the federal government the goal of ensuring that Medicaid funds are used for the people and purposes prescribed by law, regulation and the formal agreements entered in to by individual states and CMS. Medicaid services provided to eligible children in a school setting is such a purpose and Minnesota has long shared CMS' goal of ensuring that a payment system for such services be transparent, carefully managed by the Department and well-understood by local school-based providers. In Minnesota, we have worked with CMS as it has matured in its expectations of states' payment and oversight of these important services for children.

Minnesota's current allocation formula for school-based services is consistent with CMS' most recent iteration of instructions as described in its 2003 guide. This OIG report's primary audit finding occurs because Minnesota did not transition from its CMS-approved methodology to the guide-recommended methodology (the formula now applied in Minnesota) by the guide-recommended deadline of October 2003. Minnesota did, however, communicate both formally and informally with CMS about its transition plans (as required by the 2003 guide) during this period of time with no commensurate advice, caution or recommendation to amend our course.

The informality of using the 2003 guide as a vehicle for issuing policy change to states creates an ambiguous climate of voluntary compliance. Minnesota, in this case, understands the CMS policy goal of establishing a national management standard for school-based Medicaid services as they become more prevalent. We have therefore changed our system to be consistent with the expectations in the 2003 school-based guide. Given that an informal process such as this is largely dependent on states' voluntary compliance, retroactive audits and penalties to states that are already in alignment with the new standard seems counter-productive to CMS' and states' shared goal of improving the Medicaid program in a cooperative and prospective manner.

Minnesota disagrees with this report's findings for the reasons provided below.

1. Allocation Ratio.

We agree that we can only allocate costs to Medicaid to the extent that the costs relate to Medicaid-eligible children. However, we disagree with the recommendation that we refund \$9,739,500 to the federal government, along with an unspecified amount related to the un-audited agencies, for the reasons set forth below.

The recommended overpayment relates to Minnesota not implementing the change in the allocation ratio on October 1, 2003. CMS tacitly approved Minnesota's delayed effective date by failing to respond to the proposed implementation plan submitted by Minnesota. On page 45 of the guide, CMS provides that state Medicaid agencies must submit an implementation plan that includes "a comprehensive description of the mechanisms and process for claiming Medicaid administrative costs." Because CMS approved Minnesota's Local Collaborative Time Study Project in 1995, and because most of the information provided to CMS in 1994 and 1995 had not changed, we filed an implementation plan in accordance

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with the CMS guide showing only the changes that we planned to make as a result of the publication of the guide. That letter was sent to CMS on November 10, 2004, and CMS did not respond, despite Director Dennis Smith's letter promising to work with states to provide technical assistance and training. In the following year and a half, CMS has not asked for additional information, taken issue with anything in our 2004 letter, or in any way attempted to further enforce the CMS guide. If CMS did not actually receive the letter, they also did not attempt to find out why they had not received an implementation plan from Minnesota, as required by the guide.

In addition, we spoke with CMS staff via telephone conference in 2003, and were given reason to believe that states would not be held to the October 1, 2003 deadline.

Also, the draft audit report concludes that because Minnesota's ratio included both adults and children, instead of children only, this resulted in an overpayment. On the contrary, if we revise the methodology used in SFY 2004 to eliminate the data related to services provided to adults, the ratio would increase, and CMS would owe Minnesota an additional \$290,965.

While the CMS guide refers to a count of Medicaid children compared to all children, by county, school or school district, the guide does not expressly prohibit the use of other ratios, such as the one in use in Minnesota at the time of the audit. Furthermore, CMS does not have the authority to exclude other ratios by issuing "guidance" to states. Federal law requires CMS to pay matching funds for administrative expenses "...found necessary by the Secretary for the proper and efficient administration of the State plan." §1903(a)(7) of the Social Security Act. Current CMS regulation requires CMS to pay states' administrative costs that are proper and efficient. Those regulations incorporate by reference the provisions of OMB Circular A-87, 42 CFR §433.15(b)(7), 42 CFR §433.34, and 45 CFR Part 95, Subpart E. The regulations, OMB Circular A-87, and the instructions that accompany it, do not dictate a specific allocation ratio. Instead, OMB Circular A-87 provides only that costs must be "allocable" to Medicaid. Because federal regulation intentionally gives states flexibility in how to allocate costs as long as they are reasonable and necessary, CMS cannot override its own regulation to eliminate that flexibility by issuing guidance. Such a change requires formal notice and comment rulemaking in accordance with the Administrative Procedures Act.

We also contend that the CMS guide itself does not have the force and effect of law. While the May 28, 2003 letter from Dennis Smith accompanying the guide contains a statement that the provisions in the guide "represent a compilation of existing policies under the authority of current law, regulations, and guidance contained in Office of Management and Budget Circulars," the CMS guide effectively *did* change CMS policy in a number of areas. The change in the allocation ratios is just one example. These policy changes represent legislative rulemaking, which requires notice and comment in accordance with the Administrative Procedures Act. Furthermore, the Departmental Appeals Board has found that at least one policy issued in CMS' 1997 "Medicaid and School Health: A Technical Assistance Guide," that is repeated in the 2003 administrative guide, is not supported by federal statute or regulation.¹

¹ Oklahoma Health Care Authority v. CMS, HHS Department Appeals Board, Appellate Division, Doc. No. A-03-79, Dec. No. 1924, June 14, 2004.

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The draft audit report includes an overpayment finding for the quarter from July 1 to September 30, 2003. The CMS guide was not in effect during that period. It became effective October 1, 2003. The cover letter for the CMS guide provides: "...all states' school-based administrative claiming programs will need to comply with the provisions contained in the final CMS guide by October 1, 2003." We understand that some CMS staff may be of the opinion that states should have complied prior to October 1, 2003 because the *draft* guidance had been published in November, 2002. That position is contradicted by the terms of the final CMS guide itself, which asked for change by October 1, 2003.

It cannot be said that Minnesota's allocation ratio for that quarter was out of compliance with policy that pre-dated the 2003 CMS guide. The guide was the first public, final document issued by CMS, the Division of Cost Allocation, any other HHS agency, or OMB, that attempted to provide specific instruction to states on how to calculate an allocation ratio, in a school or any other setting. In addition, during the quarter ending September 30, 2003, Minnesota's allocation methodology was operating under CMS approval, which occurred in June of 1995.

2. Indirect costs. We also disagree that we claimed unallowable indirect costs for three school districts.

As noted in the draft audit report, OMB Circular A-87, Attachment A, Section C, Basic Guidelines, paragraph 3c provides: "Any cost allocable to a particular Federal award or cost objective under the principles provided for in this circular may not be charged to other Federal awards to overcome deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons." The audit report also notes that the CMS guide provides: "Certain revenues must offset allocation costs in order to reduce the total amount of costs in which the Federal government will participate. To the extent the funding sources have paid or would pay for the costs at issue, federal Medicaid funding is not available and the costs must be removed from total costs..."

We disagree with the OIG's interpretation of the above provisions. Minnesota school districts use their federal indirect cost rate assigned by the Minnesota Department of Education, in accordance with the U.S. Dept of Education, to compute allowable indirect costs. Guidance on application of existing indirect cost rates can be found in the 1997 ASMB C-10, Cost Principles and Procedures for Developing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government. Part 6, Attachment E - State and Local Indirect Cost Rate Proposals, provides significant detail on development of an indirect cost rate. However, in this case, the rate has already been developed and federally approved. Guidance on application of an existing, approved rate is only provided in section 6.2.2 and section 6.6.2.

Section 6.2.2, Direct Cost Bases, provides:

The direct cost base is used to distribute indirect costs to individual Federal awards, i.e., an indirect cost rate must be applied to a direct cost base in order to determine the amount of indirect costs. There are two basic types of direct cost bases; total direct salaries (S&W), or

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modified total directs (MTDC). MTDC exclude "any extraordinary or distorting expenditures," usually capital expenditures, subawards, contracts, assistance payments (e.g. to beneficiaries), and provider payments. The direct cost base selected should result in each award bearing a fair share of indirect costs in reasonable relation to the benefits received from those indirect costs.

Section 6.6.2, Applying the Rate to the Direct Cost Base and Calculating Claims, provides:

Once the indirect cost rate is recognized with an award document, the governmental unit is permitted to apply that rate to the applicable base of the allowable direct costs incurred during award performance...It may claim indirect costs by multiplying its indirect cost rate by the direct cost elements to which the rate may be applied under the terms of the award. Thus, its total cost recovery for the applicable period is comprised of the allowable direct costs incurred plus the allowable, allocable indirect costs.

Minnesota follows this guidance by applying the indirect cost rate assigned by the Department of Education to each school district's total direct salaries to calculate applicable indirect costs. Then, all applicable costs including payroll, indirect costs, and other direct costs are totaled and offset by applicable revenue to reduce the total amount of costs in which Medicaid will participate. We believe this process meets all federal requirements delineated in OMB Circular A-87, the CMS guide, and ASMB C-10. This calculation of indirect costs has been consistently approved since initial certification by the CMS auditor-in-charge and subsequently certified by him each quarter.

3. Cost reports. The report indicates that three school districts reported inaccurate cost reports, resulting in understated claims of \$8,738 (federal share) due to inadequate procedures for verifying the accuracy of cost report data. There is substantial oversight of the cost reports. Numerous internal desk audit procedures are in place to scrutinize each area of the cost reports. Benchmarks have been developed for each quarterly review and are used to flag possible errors which are then investigated with the appropriate county fiscal agent. The desk audits and use of benchmarks have resulted in correction of numerous errors over the years. In addition, Minnesota conducts statewide cost report training several times per year and individual technical assistance is provided as needed or requested. We believe that the procedures in place are sufficient to verify the accuracy of the 1,360 cost reports submitted annually by our local government partners, within a reasonable margin of error.

Again, thank you for the opportunity to review and comment on the draft audit report.

Sincerely,



Christine Bronson
Medicaid Director