



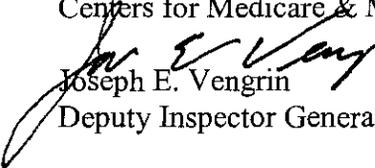
DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

APR - 4 2005

TO: Dennis G. Smith
Director, Center for Medicaid and State Operations
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of the Oklahoma Department of Human Services's Medicaid Administrative Costs (A-06-03-00046)

Attached is an advance copy of our final report on the Oklahoma Department of Human Services's (the State agency's) Medicaid administrative costs. We will issue this report to the State agency within 5 business days. The Centers for Medicare & Medicaid Services (CMS) requested this review.

Our objectives were to determine whether (1) administrative costs that the State agency claimed for the quarter ended December 31, 2002, were allowable, reasonable, and allocable for reimbursement under the Medicaid program and (2) targeted case management costs charged as administrative costs during the period September 1, 1997, through June 30, 2003, were allowable.

Office of Management and Budget Circular A-87 establishes cost principles for Federal grants to State governments. Attachment A, section C, "Basic Guidelines," provides that costs be allowable, reasonable, and allocable for reimbursement under Federal awards.

Of the \$26,451,655 in administrative costs that the State agency claimed, \$3,589,374 (\$1,799,193 Federal share) was not allowable, reasonable, or allocable for Medicaid reimbursement. We did not express an opinion on \$216,299 (\$108,150 Federal share) that the State agency claimed for employees whose salaries were allocated based on a random moment timestudy but who were not included in the timestudy universe.

In addition, from September 1997 through June 2003, the State agency inappropriately charged \$79.5 million (\$39.75 million Federal share) in targeted case management costs as administrative costs. The State agency should not have claimed targeted case management costs as administrative costs because they were separately reimbursed as a direct Medicaid service. The State agency recognized these errors and periodically made adjustments to some of its quarterly administrative cost claims to offset the costs inappropriately charged. As of the quarter ended June 30, 2003, the State agency still needed to make offsets totaling \$18,153,178 (\$9,076,589 Federal share).

With regard to administrative costs, we recommend that the State agency:

- refund to the Federal Government the \$1,799,193 that it received for unallowable administrative costs;
- discontinue claiming university indirect costs that it does not pay, as well as lawsuit settlement costs, and ensure that future administrative cost claims are made for allowable costs only;
- ensure that changes made to random moment timestudy responses are justified and documented, provide additional training to timestudy participants, and include all appropriate employees in the timestudy universe;
- resolve with CMS the \$216,299 (\$108,150 Federal share) claimed for employees excluded from the timestudy;
- credit minor refunds to its indirect costs; and
- establish review procedures to ensure that errors do not occur in the claiming of administrative costs.

With regard to targeted case management costs, we recommend that the State agency:

- refund to the Federal Government the \$9,076,589 Federal share that it received for targeted case management costs charged as administrative costs and
- discontinue claiming targeted case management costs as administrative costs.

In its written comments on our draft report, the State agency did not contest our findings on cost adjustment errors or miscellaneous overcharges. However, the State agency disputed the draft report findings and conclusions concerning administrative costs pertaining to university indirect costs and lawsuit settlement costs. We disagree with the State agency's position on both of these issues. Additionally, the State agency indicated that it had already taken corrective action regarding targeted case management costs. The State agency's comments are summarized in the body of the report and are included in their entirety as an appendix to the report.

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 Gordon L. Sato, Regional Inspector General for Audit Services, at (214) 767-8414. Please refer to report number A-06-03-00046 in all correspondence.

Attachment



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General

Office of Audit Services
1100 Commerce, Room 632
Dallas, Texas 75242

APR - 6 2005

Report Number: A-06-03-00046

Mr. Howard H. Hendrick
Director
Oklahoma Department of Human Services
P. O. Box 25352
Oklahoma City, Oklahoma 73125

Dear Mr. Hendrick:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of the Oklahoma Department of Human Services's Medicaid Administrative Costs." A copy of this report will be forwarded to the HHS action official noted below 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. 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 members of the press and general 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-06-03-00046 in all correspondence.

Sincerely,

A handwritten signature in black ink that reads "Gordon L. Sato".

Gordon L. Sato
Regional Inspector General
for Audit Services

Enclosures

Page 2 – Mr. Howard H. Hendrick

Direct Reply to HHS Action Official:

James R. Farris, M.D.
Regional Administrator
Centers for Medicare & Medicaid Services
Department of Health and Human Services
1301 Young Street, Room 714
Dallas, Texas 75202

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE OKLAHOMA
DEPARTMENT OF
HUMAN SERVICES'S
MEDICAID ADMINISTRATIVE COSTS**



**APRIL 2005
A-06-03-00046**

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:

Office of Audit Services

OIG's Office of Audit Services (OAS) provides all auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the Department.

Office of Evaluation and Inspections

OIG's Office of Evaluation and Inspections (OEI) conducts short-term management and program evaluations (called inspections) that focus on issues of concern to the department, the Congress, and the public. The findings and recommendations contained in the inspections reports generate rapid, accurate, and up-to-date information on the efficiency, vulnerability, and effectiveness of departmental programs. OEI also oversees State Medicaid fraud control units, which investigate and prosecute fraud and patient abuse in the Medicaid program.

Office of Investigations

OIG's Office of Investigations (OI) conducts criminal, civil, and administrative investigations of allegations of wrongdoing in HHS programs or to HHS beneficiaries and of unjust enrichment by providers. The investigative efforts of OI lead to criminal convictions, administrative sanctions, or civil monetary penalties.

Office of Counsel to the Inspector General

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support in OIG's internal operations. OCIG imposes program exclusions and civil monetary penalties on health care providers and litigates those actions within the department. OCIG also represents OIG in the global settlement of cases arising under the Civil False Claims Act, develops and monitors corporate integrity agreements, develops compliance program guidances, renders advisory opinions on OIG sanctions to the health care community, and issues fraud alerts and other industry guidance.

Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

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

The Oklahoma Health Care Authority administers the Medicaid program in Oklahoma. Two sister agencies, the Department of Human Services (the State agency) and the Office of Juvenile Affairs, also incur Medicaid administrative costs. These agencies submit quarterly Medicaid expenditure data to the Oklahoma Health Care Authority for compilation on the Centers for Medicare & Medicaid Services (CMS) Form CMS-64. The Federal share of Medicaid administrative costs is typically 50 percent, with enhanced rates for specific types of costs.

At the request of CMS, the Office of Inspector General (OIG) reviewed Medicaid administrative costs that the State agency claimed. We also reviewed targeted case management costs claimed as administrative costs. For the quarter ended December 31, 2002, the State agency claimed \$27,743,533: \$26,451,655 in administrative costs and \$1,291,878 in targeted case management costs.

OBJECTIVES

Our objectives were to determine whether (1) administrative costs that the State agency claimed for the quarter ended December 31, 2002, were allowable, reasonable, and allocable for reimbursement under the Medicaid program and (2) targeted case management costs charged as administrative costs during the period September 1, 1997, through June 30, 2003, were allowable.

SUMMARY OF FINDINGS

Administrative Costs

Office of Management and Budget (OMB) Circular A-87 establishes cost principles for Federal grants to State governments. Attachment A, section C, "Basic Guidelines," provides that costs be allowable, reasonable, and allocable for reimbursement under Federal awards.

Of the \$26,451,655 in administrative costs that the State agency claimed, \$3,589,374 (\$1,799,193 Federal share) was not allowable, reasonable, or allocable for Medicaid reimbursement. The State agency claimed:

- \$2,193,535 (\$1,096,768 Federal share) that it did not pay for indirect costs related to training and other services that State universities provided,
- \$795,491 (\$397,746 Federal share) of unallowable costs related to the settlement of a lawsuit,
- \$302,295 (\$151,147 Federal share) resulting from unsupported changes and inappropriate responses included in the results of a random moment timestudy,
- \$108,535 (\$54,266 Federal share) resulting from cost adjustment errors (Appendix A),

- \$48,807 (\$24,403 Federal share) because it failed to consider minor refunds, and
- \$140,711 (\$74,863 Federal share) resulting from miscellaneous overcharges (Appendix B).

We did not express an opinion on \$216,299 (\$108,150 Federal share) that the State agency claimed for employees whose salaries were allocated based on a random moment timestudy but who were not included in the timestudy universe.

Targeted Case Management Costs

From September 1997 through June 2003, the State agency inappropriately charged \$79.5 million (\$39.75 million Federal share) in targeted case management costs as administrative costs. The State agency should not have claimed targeted case management costs as administrative costs because they were separately reimbursed as a direct Medicaid service. The State agency recognized these errors and periodically made adjustments to some of its quarterly administrative cost claims to offset the costs inappropriately charged. As of the quarter ended June 30, 2003, the State agency still needed to make offsets totaling \$18,153,178 (\$9,076,589 Federal share).

RECOMMENDATIONS

With regard to administrative costs, we recommend that the State agency:

- refund to the Federal Government the \$1,799,193 that it received for unallowable administrative costs;
- discontinue claiming university indirect costs that it does not pay, as well as lawsuit settlement costs, and ensure that future administrative cost claims are made for allowable costs only;
- ensure that changes made to random moment timestudy responses are justified and documented, provide additional training to timestudy participants, and include all appropriate employees in the timestudy universe;
- resolve with CMS the \$216,299 (\$108,150 Federal share) claimed for employees excluded from the timestudy;
- credit minor refunds to its indirect costs; and
- establish review procedures to ensure that errors do not occur in the claiming of administrative costs.

With regard to targeted case management costs, we recommend that the State agency:

- refund to the Federal Government the \$9,076,589 Federal share that it received for targeted case management costs charged as administrative costs and
- discontinue claiming targeted case management costs as administrative costs.

STATE AGENCY COMMENTS AND OIG RESPONSE

In its written comments on our draft report, the State agency did not contest our findings on the items noted in Appendixes A and B. However, the State agency disputed the draft report findings and conclusions concerning administrative costs pertaining to university indirect costs and lawsuit settlement costs. We disagree with the State agency's position on both of these issues. Additionally, the State agency indicated that it had already taken corrective action regarding targeted case management costs. The State's comments are summarized in the body of our report and are included in their entirety as Appendix C.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
OBJECTIVES, SCOPE, AND METHODOLOGY	2
Objectives.....	2
Scope.....	2
Methodology.....	2
FINDINGS AND RECOMMENDATIONS	4
ADMINISTRATIVE COSTS	4
University Indirect Costs.....	4
Hissom Institution Lawsuit.....	5
Random Moment Timestudy.....	6
Cost Adjustment Errors.....	8
Minor Refunds.....	9
Miscellaneous Overcharges.....	10
TARGETED CASE MANAGEMENT	11
RECOMMENDATIONS	12
STATE AGENCY COMMENTS AND OIG RESPONSE	13
Administrative Costs.....	13
Targeted Case Management.....	15
APPENDIXES	
A – DETAILS OF COST ADJUSTMENT ERRORS	
B – DETAILS OF MISCELLANEOUS OVERCHARGES	
C – STATE AGENCY COMMENTS	

INTRODUCTION

BACKGROUND

Title XIX of the Social Security Act established the Medicaid program. The Federal and State Governments jointly fund Medicaid. Each State administers the program to assist in the provision of medical care to needy individuals who are aged, blind, or disabled and to children and pregnant women.

The Oklahoma Health Care Authority administers the Medicaid program in Oklahoma. Two sister agencies, the State agency and the Office of Juvenile Affairs, also incur Medicaid administrative costs. The Federal share of Medicaid administrative costs is typically 50 percent, with enhanced rates for specific types of costs.

The Oklahoma Health Care Authority submits quarterly claims to CMS and obtains reimbursement of Medicaid administrative costs for all three agencies. The State agency and the Office of Juvenile Affairs submit quarterly administrative expenditure data to the Oklahoma Health Care Authority, which compiles the data for CMS on Form CMS-64.

For the quarter ended December 31, 2002 (October 1, 2002, to December 31, 2002), the Oklahoma Health Care Authority claimed \$46,462,841 in total administrative costs (\$26,723,602 Federal share). The State agency incurred the majority of these costs:

Agency	Total Costs Claimed	Federal Share
State Agency ¹	\$27,743,533	\$14,542,534
Oklahoma Health Care Authority	18,257,607	11,950,217
Office of Juvenile Affairs	461,701	230,851
Total	\$46,462,841	\$26,723,602

At the request of CMS, we reviewed Medicaid administrative costs that the State agency claimed. On the basis of our initial work, we expanded our review to include targeted case management costs that the State agency claimed as administrative costs during the period September 1997 through June 2003.

The State agency assigns administrative costs to the Medicaid program through three categories—direct costs, indirect costs, and allocated direct costs:

- Direct costs benefit a single program and are charged directly to that program.
- Indirect costs benefit more than one program. The State agency assigns these costs in proportion to each program's payroll.

¹Total costs included \$1,291,878 for targeted case management. This amount is reported separately in the "Targeted Case Management" section.

- Allocated direct costs benefit multiple programs and are assigned to programs on the basis of the benefits received. The State agency uses various methods to allocate these costs, including employee hours, number of cases, and number of participants.

For one of its divisions, the State agency used a random moment timestudy to estimate the distribution of employee time. The random moment timestudy is an Intranet-based computer application in which sampled employees respond to a survey by describing the program on which they are working at a given moment. The State agency used the responses to this study to allocate approximately 70 percent of the allocated direct costs to benefiting programs. In addition, the State agency made manual adjustments at the end of the quarter to reallocate certain costs and correct errors.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine whether (1) administrative costs that the State agency claimed for the quarter ended December 31, 2002, were allowable, reasonable, and allocable for reimbursement under the Medicaid program and (2) targeted case management costs charged as administrative costs during the period September 1, 1997, through June 30, 2003, were allowable.

Scope

For the quarter ended December 31, 2002, the State agency claimed administrative costs totaling \$26,451,655 (\$13,896,595 Federal share). This amount did not include any costs for targeted case management. The costs are categorized as follows:

- direct costs – \$7,025,733 (\$4,183,351 Federal share),
- indirect costs – \$3,484,418 (\$1,742,209 Federal share), and
- allocated direct costs – \$15,941,504 (\$7,971,035 Federal share).

From September 1, 1997, through June 30, 2003, the State agency claimed \$18,153,178 (\$9,076,589 Federal share) in targeted case management costs as administrative costs. This included \$1,291,878 (\$645,939 Federal share) claimed for the quarter ended December 31, 2002.

We performed our fieldwork at the State agency office in Oklahoma City, OK, and selected State agency county offices.

Methodology

To accomplish our objectives, we:

- examined the State auditor's most recent cost allocation audit to obtain information related to the State agency's operations;
- verified the mathematical accuracy of the data that the State agency submitted to the Oklahoma Health Care Authority to support its Medicaid administrative costs (which were included on the Form CMS-64);
- reviewed the cost allocation plan effective during the quarter;
- obtained an understanding of the State agency's claims processing controls and policies by interviewing claims processing, budget, and cost allocation personnel;
- assessed the State agency's treatment of targeted case management costs;
- analyzed the distribution schedule to ensure appropriate distribution of building costs;
- interviewed staff in various State agency divisions to evaluate their Medicaid administrative costs; and
- reviewed invoices for accuracy and allowability and ensured that the State agency followed applicable accounting requirements.

In addition, we reviewed for reasonableness and accuracy the allocation methodologies that the State agency used to assign costs to Medicaid. Our efforts focused primarily on the random moment timestudy allocation method because it made up the majority of the allocated costs. In our review, we:

- interviewed system programmers to obtain an understanding of the State agency's statistical sampling program,
- tested the random moment timestudy universe for completeness and accuracy, and
- interviewed selected State agency personnel eligible for the random moment timestudy to determine their understanding of the study and to gain an understanding of the State agency's study training.

We also reviewed all Medicaid adjustments over \$2,000 for allowability and accuracy.

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

FINDINGS AND RECOMMENDATIONS

ADMINISTRATIVE COSTS

University Indirect Costs

The State agency claimed indirect costs that it did not incur as Medicaid administrative costs. The State agency contracted with State universities to provide training and other services and claimed indirect costs that it did not pay to the universities as Medicaid expenditures. A State agency may not claim or receive Federal funds for money that it did not expend. CMS officials concurred with our finding, indicating that only the indirect costs that the State agency actually paid were valid Medicaid costs. The State agency claimed \$2,193,535 (\$1,096,768 Federal share) for university indirect costs that it did not pay.

The State agency received \$1,096,768 in Federal funds for university indirect costs that exceeded the contracted amounts paid to the universities.

Attachment A of OMB Circular A-87 defines cost as “an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency.” The position of CMS, the cognizant Federal agency, is that it will allow the State agency to claim as administrative costs the lower of (1) the indirect cost rate that the universities negotiate with the Department of Health and Human Services, Division of Cost Allocation or (2) the indirect cost rate the State agency actually pays the universities, as specified in the contracts.

The State agency often contracts with State universities to provide training to its employees. The contracts specify that the State agency will pay the universities an indirect cost rate ranging from zero indirect costs to a little over 13 percent of direct costs. The State agency negotiated a lower indirect cost rate with the universities to lessen its costs of doing business. However, the State agency did not pass the cost savings on to the Federal Government, but rather claimed higher indirect cost amounts as administrative costs and received Federal reimbursement for them.

State Agency Contracts

State agency officials told us that for about 12 years, the State agency claimed indirect costs that it did not pay as Medicaid administrative costs for one university training contract. The State agency claimed the indirect cost rate specified in the contract and additional amounts that it did not pay the university. These additional amounts were based on the university’s assertion that its actual indirect costs were higher than the contractual amounts it charged the State agency.

During budget meetings in December 2002, State agency officials discovered additional contracts between other State agency divisions and universities. In December 2002, the State agency calculated the difference between the indirect costs that it paid under these contracts and the amount that the universities identified as their actual indirect costs. The State agency claimed these amounts as retroactive adjustments to its Medicaid administrative cost claim for the previous 2-year period. The adjustments totaled \$2,193,535, meaning that the State agency received an additional \$1,096,768 Federal share for money that it did not expend.

Conclusion

Although the State agency negotiated a lower indirect cost rate with universities that represented what it actually paid, it billed Medicaid for additional indirect costs that it did not pay. The indirect costs were not valid Medicaid costs because the State agency did not expend the money as part of the university contracts.

Hisson Institution Lawsuit

The State agency claimed administrative costs from a lawsuit filed against Hission Memorial Center, a State institution for the mentally retarded. CMS did not approve such costs. The State agency claimed \$795,491 (\$397,746 Federal share) in costs related to the lawsuit settlement.

The State agency received \$397,746 in Federal funds for unallowable costs related to the settlement of a lawsuit.

Attachment B, part 20 of OMB Circular A-87 indicates that settlement costs are generally not allowable:

Fines, penalties, damages and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

Parents of patients in the Hission Memorial Center sued the State agency in 1985, claiming that their children were being abused and mistreated. The State agency was found in violation of Federal law, and the institution was eventually closed. As part of the consent decree settling the litigation, the court ordered the State agency to:

- provide professional advocacy services to class members of the lawsuit;
- contract with an independent agency to recruit and train volunteer advocates; and
- maintain a court-appointed oversight committee to assist the court, the class members, and the State agency in carrying out the settlement conditions.

The State agency claimed the costs of carrying out these requirements as Medicaid administrative costs. Further, because the lawsuit will continue until the State agency is found to be in complete compliance with the settlement, the State agency continues to charge its court costs, such as its legal representation through the Attorney General and expert witnesses, as Medicaid administrative costs.

State agency officials did not believe that the court-ordered settlement fell under the A-87 provision. They said that “settlement” as used in A-87 applied to cash payments made to the

lawsuit class members. Because no such cash payments were made, the State agency believed that it could claim all costs related to the court order as administrative costs.

We believe that the Hissom lawsuit costs should be considered “other settlements” as described in A-87 because they were a direct result of the consent decree between the plaintiffs and the State agency. The costs did not exist before the lawsuit and would not have been incurred otherwise. In addition, CMS did not provide the State agency with written authorization approving such costs.

Further, language in the consent decree indicated that the decree was in settlement of the lawsuit:

Plaintiffs, representing the class of present and certain former residents of the Hissom Memorial Center (THMC), and defendants hereby agree to the entry of this Decree in settlement of this litigation

In accordance with the foregoing, it is hereby ORDERED that the Consent Decree submitted by Plaintiffs and Defendants be and hereby is APPROVED and ADOPTED as the Order of the Court

State agency officials told us that CMS was aware that the State agency was claiming these costs. However, CMS officials informed us that they were not aware that the costs were being claimed. Neither CMS nor State agency officials could provide documentation that CMS approved the settlement costs.

During the quarter ended December 31, 2002, the State agency claimed costs related to the Hissom litigation settlement as Medicaid administrative costs totaling \$795,491 (\$397,746 Federal share), broken down as follows:

- \$506,515 (\$253,257 Federal share) for professional advocacy services,
- \$98,665 (\$49,333 Federal share) for the recruitment and training of volunteer advocates,
- \$152,274 (\$76,137 Federal share) for a court-appointed oversight committee,
- \$36,633 (\$18,317 Federal share) for legal representation through the Attorney General, and
- \$1,404 (\$702 Federal share) for an expert witness.

Random Moment Timestudy

Adult Protective Services

Through its random moment timestudy, the State agency inappropriately charged costs for the adult protective services unit to Medicaid. The State agency recoded study responses

The State agency received \$151,147 in Federal funds resulting from unsupported changes and inappropriate responses included in the results of a random moment timestudy.

without justification or supporting documentation, and some respondents submitted inappropriate responses. As a result, the Medicaid program was overcharged \$302,295 (\$151,147 Federal share).

Adult protective services specialists investigate referrals of abuse, neglect, and exploitation of vulnerable adults. The State agency receives Federal funding for adult protective services through a Title XX Social Services block grant.

During the quarter ended December 31, 2002, the State agency allocated \$302,295 (\$151,147 Federal share) to Medicaid administrative costs. Attachment A of OMB Circular A-87 states that costs are 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.

Of the 113 random moment timestudy responses from adult protective services specialists, only 6 initially related to Medicaid. The cost allocation staff, without justification or supporting documentation, subsequently recoded an additional 35 responses. The recoding changed the funding from Title XX to the Medicaid, food stamps, and childcare programs. According to a State agency official, the six responses initially coded to Medicaid contained response codes that were inappropriate for adult protective services workers. Therefore, none of the original responses related to the Medicaid program.

Recoded Responses

State agency officials decided to recode certain responses because they believed that the specialists were probably confused by the study response codes, given that codes the specialists chose represented areas outside their specialty. However, the State agency did not contact the specialists to ensure the accuracy of the recoded responses. Further, the State agency did not document that Medicaid benefited from the specialists' work. The specialists whom we interviewed said that their involvement with the Medicaid program was limited to occasionally completing a Medicaid eligibility application. Therefore, we believe that the State agency should charge Medicaid only when there is documented evidence that the specialists' activities benefited the Medicaid program.

We interviewed 43 study participants at 3 selected county offices. Only 17 of these 43 participants recalled receiving training on the study. Most of the 17 participants commented that the training was not adequate because it focused on the mechanics of using the new Web-based system rather than the actual meaning of the response codes. Of the remaining 26 participants, 7 stated that they did not receive training, and 19 could not recall if they received training.

Through the random moment timestudy, the State agency inappropriately claimed \$302,295 (\$151,147 Federal share) in Medicaid administrative expenses for adult protective services.

Employees Excluded From Random Moment Timestudy

The State agency charged costs to Medicaid for 63 employees on the basis of the random moment timestudy results even though these employees were excluded from the study. The employees were excluded because of a lack of Intranet access, State agency practice, or simple error. However, the State agency determined that these 63 employees worked in the Medicaid program. The State agency claimed \$216,299 (\$108,150 Federal share) for these employees.

Attachment B of OMB Circular A-87 states that the sampling universe must include all of the employees whose salaries and wages are to be allocated on the basis of sample results.

The State agency excluded 63 employees from the sampling universe, even though their salaries and wages were allocated based on the random moment timestudy sample results, as follows:

- 51 school-based employees,
- 11 part-time employees, and
- 1 employee located at a substance abuse clinic.

The State agency received \$108,150 in Federal funds for 63 employees whose salaries were allocated based on a random moment timestudy but who were not included in the timestudy universe.

The State agency excluded the employees for the following reasons:

- School-based employees were excluded because they could not access the State agency's Intranet from their schools.
- Part-time workers were excluded pursuant to the State agency's policy.
- One employee at a substance abuse clinic was inadvertently excluded because State agency officials were unaware that the employee's salary and wages were allocated based on the study results.

Because the 63 excluded employees did not have a chance to be sampled, we cannot express an opinion on the \$216,299 (\$108,150 Federal share) in Medicaid administrative costs related to these employees.

Cost Adjustment Errors

The State agency made 32 manual adjustments to the Medicaid administrative costs claimed during the quarter. This did not include the adjustments made for university indirect costs. These 32 adjustments increased the charges to the Medicaid program by \$3,061,839 (\$1,530,965 Federal share). We reviewed the 28 adjustments that affected Medicaid claimed costs by more than \$2,000. Six of the adjustments contained errors that generally resulted in cost allocations to the Medicaid program

The State agency received \$54,266 in Federal funds due to cost adjustment errors.

without corresponding benefits. One error reduced Medicaid administrative costs. The State agency agreed that the six adjustments contained errors.

The adjustment errors were as follows:

Adjustment	Total Cost	Federal Share
Mail center overhead	\$114,265	\$57,132
Depreciation	(16,492)	(8,246)
Building security	3,800	1,900
Inspector general office	2,418	1,209
Payroll from data services	2,895	1,447
Payroll from finance	1,649	824
Total	\$108,535	\$54,266

See Appendix A for a detailed explanation of each adjustment error.

Attachment A of OMB Circular A-87 states that costs are 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.

These adjustment errors were the result of charging the same costs twice or assigning costs to the wrong division or program. A State agency official told us that the adjustments had not been reviewed for completeness and accuracy.

Including the error in favor of the Medicaid program, the State agency overstated its administrative costs by \$108,535 (\$54,266 Federal share).

Minor Refunds

The State agency failed to consider if minor refunds should be credited to the Federal programs that funded the original administrative expenses. By not crediting the minor refunds and reimbursements, the State agency claimed excess Medicaid administrative costs totaling \$48,807 (\$24,403 Federal share).

<p>The State agency received \$24,403 in Federal funds because it failed to consider minor refunds.</p>

OMB Circular A-87, Attachment A, part C(i) requires that costs be net of all applicable credits to be allowable. Also, OMB Circular A-87, Attachment A, part C(4)(a) defines applicable credits as those receipts or reductions of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs.

The State agency received minor refunds related to expenditures that were originally funded through Federal awards. Examples of such refunds are utility reimbursements from other entities that share space with the State agency, auctions of surplus equipment, and money that prospective foster parents pay for background checks. Some of the refunds met the OMB

definition of applicable credits. However, the State agency deposited the money in its general fund rather than crediting the refunds to Federal programs.

State agency officials told us that it would be extremely difficult and time consuming to determine the exact program that originally funded an expenditure for which a refund is received. The officials said that the State agency would need to hire at least one additional staff member to track and apply minor refunds to the original funding program and that such a move would not be cost effective.

OMB Circular A-87, Attachment A, part E(3) supports the concept of crediting minor refunds to the State agency's indirect costs: "Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of costs is consistently applied to all cost objectives."

During our audit, the State agency devised a method to easily identify minor refunds related to items that were originally paid as Federal program administrative costs. This method could not determine the exact program that originally funded the expenditure but could identify a refund related to a Federal administrative expenditure. State agency officials commented that crediting the refunds to indirect costs would ensure that all federally funded programs receive a benefit from the minor refunds.

Using this new method, we determined that the State agency claimed excess Medicaid administrative costs totaling \$48,807 (\$24,403 Federal share).

Miscellaneous Overcharges

We identified 11 miscellaneous issues that resulted in a \$140,711 (\$74,863 Federal share) overstatement of Medicaid administrative costs.

The State agency received \$74,863 in Federal funds resulting from miscellaneous overcharges.

Attachment A of OMB Circular A-87 states that costs are 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 table on the next page summarizes the overcharges:

Miscellaneous Issue	Total Cost	Federal Share
Building security	\$30,995	\$15,497
Fraud and abuse unit	29,789	14,894
Indirect costs	19,919	9,960
Utica Park clinic services	19,490	9,745
Alzheimer's coalition costs	17,776	13,332
Community services unit	9,374	4,687
Building grounds/telephone	6,985	3,493
Software development	5,368	2,684
Community relations costs	626	313
Travel/training expense	250	188
Child support hearing unit	139	70
Total	\$140,711	\$74,863

See Appendix B for detailed information about each issue.

Causes of the overcharges included errors in compiling allocation data, errors in assigning costs to the appropriate program (e.g., coding costs to the wrong program within the State agency's accounting system or coding costs to the wrong vendor contract), and inadequate communication between different State agency units or divisions. As a result, the State agency overstated its administrative costs by \$140,711 (\$74,863 Federal share).

TARGETED CASE MANAGEMENT

The State agency charged targeted case management costs as both a direct Medicaid service cost and a Medicaid administrative expense. This action resulted in duplicate costs to the Medicaid program. The State agency recognized this error and attempted to remove the duplicate costs by periodically making decreasing adjustments to its quarterly administrative cost claims.

The State agency received \$9,076,589 in duplicate Federal funds because targeted case management costs were inappropriately claimed as administrative costs.

The adjustments, however, did not fully offset the approximately \$79.5 million in targeted case management costs charged as administrative costs from September 1997 through June 2003. As a result, the State agency overclaimed administrative costs by \$18,153,178 (\$9,076,589 Federal share).

Attachment A of OMB Circular A-87 provides that for a cost to be allowable, it must be reasonable. It is not reasonable for the State agency to claim targeted case management costs on its quarterly administrative claim because these costs are separately reimbursed as a direct Medicaid service.

The State agency had charged targeted case management costs as administrative costs since the program's inception in September 1997. The State agency intended to offset the charges so that no targeted case management costs were charged administratively. However, determining the actual costs associated with targeted case management (e.g., payroll and benefits for employees

providing the services and overhead costs) was difficult, and the State agency did not want to perform this detailed analysis each quarter. As a result, the State agency decided to (1) estimate the quarterly costs and make a decreasing adjustment to its administrative cost claims and (2) annually reconcile the actual targeted case management costs to the sum of the decreasing adjustments.

The State agency did not consistently make adjustments to quarterly claims. For some quarters, the State agency did not make decreasing adjustments, whereas for other quarters, the adjustment did not accurately reflect the actual expenditures. The State agency planned to reimburse CMS the amount that it owed or collect the amount that it was due as a result of its annual reconciliation. However, through oversight, the State agency did not always reimburse CMS the amount that it owed.

The State agency reconciled its targeted case management costs from the program's inception in September 1997 through June 2003. The State agency determined that it had claimed \$79,492,700 in targeted case management costs as administrative costs and made periodic adjustments totaling \$61,339,522 to offset the claimed costs. As a result, the State agency overclaimed \$18,153,178 (\$9,076,589 Federal share).

State agency officials acknowledged this overclaim. As part of the reconciliation, the State agency also calculated that it underbilled targeted case management services by \$5,727,946.

The State agency planned to repay the \$18,153,178 through one reduction to its September 2003 administrative cost claim or through reductions to the September and December 2003 administrative claims. The State agency also planned to work with CMS and the Oklahoma Health Care Authority to recover the funds underbilled for targeted case management services.

RECOMMENDATIONS

With regard to administrative costs, we recommend that the State agency:

- refund to the Federal Government the \$1,799,193 that it received for unallowable administrative costs;
- discontinue claiming university indirect costs that it does not pay, as well as lawsuit settlement costs, and ensure that future administrative cost claims are made for allowable costs only;
- ensure that changes made to random moment timestudy responses are justified and documented, provide additional training to timestudy participants, and include all appropriate employees in the timestudy universe;
- resolve with CMS the \$216,299 (\$108,150 Federal share) claimed for employees excluded from the timestudy;
- credit minor refunds to its indirect costs; and

- establish review procedures to ensure that errors do not occur in the claiming of administrative costs.

With regard to targeted case management costs, we recommend that the State agency:

- refund to the Federal Government the \$9,076,589 Federal share that it received for targeted case management costs charged as administrative costs and
- discontinue claiming targeted case management costs as administrative costs.

STATE AGENCY COMMENTS AND OIG RESPONSE

Administrative Costs

In its written comments on the draft report, the State agency did not contest our findings on the items noted in Appendixes A and B. However, the State agency disputed the draft report findings and conclusions concerning administrative costs pertaining to university indirect costs and lawsuit settlement costs. The State agency comments are included in their entirety as Appendix C and are summarized below.

University Indirect Costs

The State agency disagreed with our finding on university indirect costs, commenting that the draft report's assertion that the State of Oklahoma had claimed reimbursement for indirect administrative costs that it did not pay was incorrect because the State incurred all of the costs in question as a direct expense of the State agency or as a "certified public expenditure" of the university. The State agency believed that claiming the indirect costs that it did not pay was an acceptable practice pursuant to 42 CFR § 433.51, which recognizes that a State can seek Federal reimbursement for funds paid directly by a State agency or funds certified by a contributing public agency. The contractual language between the State agency and the university indicated that the university would contribute the difference between the indirect cost rate agreed to in the contract (13.175 percent of direct costs) and the indirect cost rate that the university said was its actual rate (59.2 percent of direct costs). As a result, the State agency believed that it could claim the 59.2 percent rate and receive Federal funding.

OIG Response

Although the State agency negotiated a lower indirect cost rate with universities that represented what it actually paid, it billed Medicaid for additional indirect costs that it did not pay. We believe that the indirect costs were not valid Medicaid expenditures because the State agency did not expend the money as part of the university contracts.

We disagree with the State agency's position that 42 CFR § 433.51 permits it to claim contributed indirect costs. The conditions contained in this regulation were not intended to disturb the basic statutory requirement that the State share is for "expenditures" under the State plan (section 1902(a)(2) of the Social Security Act). Our position and the position of CMS, the

cognizant Federal agency, is that the State agency may claim only indirect costs that it actually paid to the universities through the contracts.

Hissom Institution Lawsuit

The State agency disagreed with the Hissom Institution lawsuit finding because it believed that the language in OMB Circular A-87 excluded only monetary payments resulting from a lawsuit. The State agency's assertion hinged on the "Fines and penalties" heading, under which the criterion supporting the disallowance was included. The State agency said that the legal definitions of fines and penalties applied exclusively or primarily to monetary payments and did not include the costs we disallowed. To support its position, the State agency cited three Departmental Appeals Board (DAB) decisions that discussed the OMB Circular A-87 language in question.

Finally, the State agency claimed that it was not reasonable to expect categorization of some costs that arise from the settlement of a case. The State agency explained that States continuously implement modifications to their programs on the basis of several factors, such as legislation, litigation or the threat of such, and programmatic reviews. The State agency believed that in the Hissom case, it simply chose to redirect spending from one area to another at no additional cost. The State agency believed that it was unreasonable to identify settlement costs and not claim reimbursement for those costs when they would be allowable if the litigation had not taken place.

OIG Response

We disagree with the State agency's position that OMB Circular A-87 excludes only monetary payments resulting from lawsuits. Two of the three DAB decisions that the State agency cited in its comments (DAB Nos. 978 and 933) indicate that the heading is not intended to limit the language of the section of OMB Circular A-87 used to support the disallowance. One of the decisions (DAB No. 978) states that "the purpose of the headings in the part of the Circular containing the principles for specific items of cost is to serve as a means of alphabetizing the various cost principles so that they may be referred to more readily, not to limit the language of the text." Pursuant to this DAB statement, we believe, as stated in the report, that the Hissom Institution lawsuit costs fall under "other settlements" identified as unallowable in OMB Circular A-87.

The State agency's position that the costs were redirected from one area to another at no additional cost is incorrect. The administrative costs that we questioned (we did not audit the Medicaid services that the State agency provided) related specifically and solely to additional monies that the State agency would not have spent had it not violated Federal law. These additional costs could have been avoided had the State agency properly administered the program, a concept that DAB No. 978 supports. According to officials in the State agency's Office of Client Advocacy, the office was created because of the lawsuit, and for those clients living in a community setting, the professional advocacy services were available only to Hissom class members. Further, any court costs (i.e., the court-appointed oversight committee, legal

representation, and expert witness) certainly would not exist if the State agency had not violated Federal law.

Targeted Case Management

In its written comments on the draft report, the State agency indicated that “the inappropriately charged ‘targeted case management’ costs . . . have already been satisfied by the State of Oklahoma.”

APPENDIXES

DETAILS OF COST ADJUSTMENT ERRORS

The State agency made errors on six cost adjustments, as shown in the table below. A description of each adjustment error follows the table.

Adjustment	Total Cost	Federal Share
Mail center overhead	\$114,265	\$57,132
Depreciation	(16,492)	(8,246)
Building security	3,800	1,900
Inspector general office	2,418	1,209
Payroll from data services	2,895	1,447
Payroll from finance	1,649	824
Total	\$108,535	\$54,266

- **Mail center overhead:** The State agency allocated mail center overhead costs according to the proportion of mail usage and assigned the costs through a manual adjustment. The adjustment contained two errors: (1) postage costs that were charged in a previous period were incorrectly charged again and (2) the overhead allocable to one division was incorrectly assigned to another division. As a result, Medicaid costs were overstated by \$114,265 (\$57,132 Federal share). State agency officials agreed that Medicaid costs were overstated and informed us that they had corrected the errors.
- **Depreciation:** The State agency depreciated equipment through manual adjustments. These adjustments assigned depreciation for two pieces of data processing equipment to the Medicaid program. However, the State agency claimed only 1 month of depreciation during the quarter rather than all 3 months. This resulted in Medicaid costs being understated by \$16,492 (\$8,246 Federal share). State agency officials agreed that Medicaid costs were understated and informed us that they had corrected the error.
- **Building security:** The State agency made a retroactive adjustment to allocate security costs of its main office building to the appropriate programs. However, \$14,253 was charged twice, resulting in an overstatement to Medicaid of \$3,800 (\$1,900 Federal share). State agency officials agreed that Medicaid costs were overstated and informed us that they had corrected the error.
- **State agency's inspector general office:** The State agency made an adjustment to move costs associated with its inspector general office to the divisions that the office supported. One primary program was mistakenly left out of the adjustment calculation. As a result, Medicaid costs were overstated by \$2,418 (\$1,209 Federal share). State agency officials agreed that Medicaid costs were overstated.
- **Payroll costs charged to benefiting programs:** The State agency made two adjustments to change certain employees' payroll costs from their assigned funding programs to the programs on which they actually worked. However, the first adjustment incorrectly captured the payroll amounts for two employees, resulting in an overstatement to

Medicaid of \$2,895 (\$1,447 Federal share). The second adjustment changed overtime payroll and temporary employee payroll and benefits costs for certain employees. The adjustment, however, did not include all appropriate employees. As a result, Medicaid costs were overstated by \$1,649 (\$824 Federal share). State agency officials agreed that Medicaid costs were overstated.

DETAILS OF MISCELLANEOUS OVERCHARGES

We identified 11 miscellaneous issues that resulted in an overstatement of Medicaid costs, as shown in the table below. A description of each issue follows the table.

Miscellaneous Issue	Total Cost	Federal Share
Building security	\$30,995	\$15,497
Fraud and abuse unit	29,789	14,894
Indirect costs	19,919	9,960
Utica Park clinic services	19,490	9,745
Alzheimer's coalition costs	17,776	13,332
Community services unit	9,374	4,687
Building grounds/telephone	6,985	3,493
Software development	5,368	2,684
Community relations costs	626	313
Travel/training expense	250	188
Child support hearing unit	139	70
Total	\$140,711	\$74,863

- **Building security:** The State agency mistakenly charged security costs for its main office building directly to Medicaid, although other programs benefited from these costs. During the quarter we reviewed, the State agency decided that all programs should share building security costs and manually adjusted those costs into indirect State costs. However, the State agency was unaware that building security had already been mistakenly charged directly to Medicaid and did not correct this mistake. Thus, Medicaid administrative costs were overstated by \$30,995 (\$15,497 Federal share).
- **Fraud and abuse unit:** The State agency allocated its fraud and abuse unit's costs on the basis of the unit's caseload. The individual within the fraud and abuse unit who compiled caseload information mistakenly included cases that benefited more than one program two or three times in the case count, rather than splitting these cases equally among the benefiting programs (e.g., a case that benefited three programs should have been split 1/3 to each benefiting program instead of adding an entire case to each program). The employee also excluded cases benefiting State programs. Because of these errors, Medicaid administrative costs were overstated by \$29,789 (\$14,894 Federal share).
- **Indirect costs:** The State agency allocated indirect costs using the proportion of direct payroll and benefits for each funding program (e.g., Medicaid, food stamps, child welfare). The individual responsible for calculating the indirect cost percentages excluded the payroll and benefits for child welfare when determining the allocation rates for two types of indirect costs (State office administration and statewide cost allocation). Because of this exclusion, Medicaid administrative costs were overstated by \$19,919 (\$9,960 Federal share).

- Utica Park clinic services: A vendor had two contracts with the State agency: one to provide State-funded medical services and one to provide evaluations to determine State Medicaid waiver eligibility. Because of an error in a contract change order, the State agency inappropriately charged the medical services to the Medicaid waiver contract. As a result, Medicaid administrative costs were overstated by \$19,490 (\$9,745 Federal share).
- Alzheimer's coalition costs: The State agency received an Alzheimer's coalition grant to fund the costs of one employee that were previously charged as Medicaid administrative costs. While the employee was working exclusively on the Alzheimer's coalition grant, the employee's costs (e.g., payroll and benefits) should have been charged to the grant. However, the State agency continued to charge the employee's costs to Medicaid. For the quarter we reviewed, the State agency incorrectly charged \$17,776 (\$13,332 Federal share) as Medicaid administrative costs.
- Community services unit: The State agency allocated costs of its community services unit on the basis of employee hours. The individual who prepared the summary schedule of employee hours made multiple mistakes, such as transposing numbers and assigning employee hours to the wrong programs. These errors resulted in an overstatement of Medicaid administrative costs totaling \$9,374 (\$4,687 Federal share).
- Building grounds/telephone: The State agency assigned certain overhead costs for county office locations (e.g., rent, utilities, and maintenance) to the funding programs through a distribution schedule that was based on the percentage of full-time employees occupying the location. The distribution schedule excluded one program's full-time employees, which resulted in overstating Medicaid administrative costs by \$6,985 (\$3,493 Federal share).
- Software development: The State agency incorrectly charged costs associated with adult protective services software development as Medicaid administrative costs. The State agency approved a project to develop software that totally benefited Medicaid and subsequently decided to develop adult protective services software that did not benefit Medicaid. The new software development was charged to the same cost stream as the allowable Medicaid software project, resulting in an overstatement of Medicaid administrative costs totaling \$5,368 (\$2,684 Federal share).
- Community relations costs: The State agency directly charged Medicaid \$2,500 that should have been allocated to multiple programs. As a result, Medicaid administrative costs were overstated by \$626 (\$313 Federal share).
- Travel/training expense: The State agency claimed one individual's lodging costs for attending a conference twice because the hotel double billed for the lodging. As a result, Medicaid administrative costs were overstated by \$250 (\$188 Federal share).

- Child support hearing unit: The State agency charged costs supporting the child support hearing unit as indirect costs rather than direct costs, which caused Medicaid administrative costs to be overstated by \$139 (\$70 Federal share).

**OKLAHOMA DEPARTMENT OF HUMAN SERVICES**

Sequoyah Memorial Office Building
P.O. Box 25352
Oklahoma City, OK 73125-0352
(405) 521-3646 • www.okdhs.org



September 21, 2004

Mr. Gordon L. Sato
Regional Inspector General
For Audit Services
Department of Health & Human Services
1100 Commerce, Room 632
Dallas, TX 75242

Re: Response to Office of Inspector General Draft Report No. A-06-03-00046 ("Review of the Oklahoma Department of Human Services' Medicaid Administrative Costs")

Dear Mr. Sato:

The Oklahoma Department of Human Services ("OKDHS") has now completed its detailed review of the United States Department of Health and Human Services Office of Inspector General ("OIG") draft report no. A-06-03-00046 entitled "Review of the Oklahoma Department of Human Services' Medicaid Administrative Costs" offers the following comments for consideration by you in preparing your final report.

At the outset, OKDHS does not contest the OIG findings with respect to the items noted in Appendix A ("Details of Cost Adjustment Errors") and Appendix B ("Details of Miscellaneous Issues") of the draft report. Rest assured, OKDHS has already taken steps to remedy the problems with the expense items identified in the appendices and will work to prevent their recurrence in the future. Also, it is my understanding that the inappropriately charged "targeted case management" costs discussed at page 12 of the draft report have already been satisfied by the State of Oklahoma. However, OKDHS does indeed contest the draft report's findings and conclusions concerning administrative costs pertaining to the "University Indirect Costs" (at page 4) and the "Hissom Institution Lawsuit" (at page 5) as set out in detail below.

University Indirect Costs

The draft report incorrectly suggests that the State of Oklahoma has claimed reimbursement for indirect administrative costs that it did not pay. This section of the draft report fails to recognize that all of the costs in question were incurred by the State either as a direct expense of OKDHS or as a "Certified Public Expenditure" of the University of Oklahoma ("University"). The costs in question arise as a part of contracts that OKDHS enters into with the University to provide training services to its employees. The auditors reviewed the contract between the two state entities, which provides that OKDHS will reimburse the University for 13.175% of its direct costs to cover part of its indirect costs, and the draft concludes that only this percentage can be claimed as an

Mr. Gordon L. Sato
September 21, 2004
Page 2

allowable indirect cost. That conclusion, however, ignores the rest of the contractual language, which provides that the University will contribute the difference between the 13.175% and its actual indirect costs of 59.2%. The contract provides that in providing comprehensive social service and professional skills training to OKDHS personnel the University "shall contribute an amount of documented costs equal to the difference between 13.175% of total direct costs "and the calculated [Facilities & Administration] rate of 59.2%."

The OIG's draft report suggests that the difference between the 13.175% cash payment from OKDHS and the actual incurred costs of 59.2% represents a "cost savings" that the agency should have passed on to the Federal Government. Although there might be a "savings" if the agency were contracting with an outside, private entity, that characterization is wrong where, as here, the costs are instead being shared by two state agencies. Any "savings" that OKDHS might realize by paying 13.175% rather than 59.2% is an additional cost that the University--a sister state entity--incurs. The contract between the two state agencies acknowledges that the indirect costs in question amount to 59.2% and that OKDHS will cover 13.175%, while the University covers the remainder. Regardless how these costs are allocated between the two state entities, the State has incurred and paid indirect costs equivalent to 59.2% of its direct costs. The fact that some of the costs are paid through OKDHS appropriated funds and some through expenditures certified by the University is irrelevant, as federal regulations repeatedly recognize that a State can seek federal financial participation (FFP) for funds paid directly by a state agency or funds certified by a contributing public agency as representing expenditures eligible for FFP. See 45 C.F.R. §235.66 (TANF); 45 C.F.R. §304.30 (child support enforcement); and 42 C.F.R. §433.51 (Medicaid).

The draft report also notes that CMS officials assert that the indirect cost rate that the University has "negotiated" with the Division of Cost Allocation ("DCA") is a limit on any such costs that can be claimed in the Medicaid context. See Draft Report at p. 4. The DCA has published two sets of indirect rates for the University in providing "instruction/public service." One of these rates "caps" certain administrative costs (for a total indirect cost rate of 47.3%), and the other does not (for a total indirect cost rate of 59.2%). The capped rate is used in some circumstances and the actual, uncapped rate is used in others (for example, contracts with the Department of Defense). In any case, the negotiated capped rate applies only to certain "grants, contract and other agreements" covered by OMB Circular A-21. The indirect costs considered in the draft report result from a relationship between OKDHS and CMS, which is covered by OMB Circular A-87 (covering State, Local and Indian Tribal Governments), rather than Circular A-21 (which covers Educational Institutions).

For all of these reasons, this section of the draft audit should be amended to reflect that the claimed indirect cost rate of 59.2% reflected actual costs borne by state entities and properly claimed for federal financial participation.

Mr. Gordon L. Sato
September 21, 2004
Page 3

Hissom Institution Lawsuit

The draft report also erroneously concludes that the State should not be allowed to claim administrative costs related to the Hissom Institution lawsuit (*Homeward Bound v. Hissom Memorial Center*, Case No. 85-C-437-E (N. D. Okla.)). The position taken in the draft audit unreasonably interprets the language in OMB A-87 that prohibits federal financial participation in “fines, penalties, damages and other settlements.” The notion that this prohibition includes not only monetary payments (not at issue here) but also expenses associated with general program administration is not faithful to the language of the Circular, goes beyond any previous interpretation of which the State is aware, and would be impossible to apply with any consistency or certainty.

OMB Circular A - 87 states that “fines and penalties” are an unallowable administrative cost. The specific provision states:

“16. Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local or Indian tribal laws and regulations are unallowable...”

OMB Circular A - 87, Attachment B, ¶16. The draft report directs that administrative costs resulting from certain services provided under the consent decree should be disallowed as “other settlements” under this provision.

There is no basis for the position taken in the draft report. The reference to “other settlements” in paragraph 16 must be read in harmony with the terms that precede it, all of which refer exclusively or primarily to **monetary** payments.¹ The heading of the paragraph --“fines and penalties”-- likewise refers exclusively to monetary payments. Similarly, every application of the disputed language that the State has been able to find, applies the “fines and penalties” provision to a required monetary payment. Generally, the available interpretations have held that payments for improperly withheld benefits or tax payments were an allowable cost, though the interest ordered to be paid on those amounts was unallowable. See *California Department of Health Services*, DAB Decision No 1274 (9/9/91), *California Department of Health and Human Services*, DAB Decision No. 978 (8/10/88), and *Massachusetts Department of Public Welfare*, DAB Decision No. 933 (2/4/88).

In *California Department of Health Services*, DAB Decision No. 1274, the Board determined that the State could claim federal participation for court ordered payments

¹ Black's Law dictionary describes “fine” (“a pecuniary punishment or penalty”) and “damages” (“a pecuniary compensation or indemnity”) as exclusively monetary in nature, and “penalty” as a term whose meaning is “generally confined to pecuniary punishment.” See BLACK'S LAW DICTIONARY 389, 632, and 1133 (6th ed. 1990)

Mr. Gordon L. Sato
September 21, 2004
Page 4

to the plaintiffs for certain AFDC benefits that had been improperly denied or underpaid, but that the interest paid on those withheld payments was unallowable pursuant to the "fines and penalties" section of OMB Circular A-87. In order to discern the Circular's meaning, the Board principally relied upon a Title IV-A program regulation guide, which provided:

Federal financial participation shall not be available for court imposed penalty payments (*payments in addition to amounts of assistance provided to eligible individuals under an approved State plan*) such as interest payments, compensatory damages, punitive damages, etc., resulting from incorrect State agency action as determined by the court.

California Department of Health and Human Services, DAB Decision No. 978, p. 2 (*quoting* APA-PRG-10) (emphasis added). This interpretive document characterizes the "fines and penalties" section as addressing "payments" and further notes that it is limited to those payments that are in addition to assistance provided. The amounts that the draft audit has identified as "other settlements," by contrast, are amounts expended in administering the Medicaid program, not penalty payments resulting from litigation.²

Not only is the position taken in the draft audit an unreasonable interpretation of the language in Circular A-87, but it is completely unworkable in practice. States are continuously implementing modifications to their programs and to program administration. Some of these changes are required by legislation; some by litigation; some by the threat of litigation; some as a result of programmatic reviews. Most often, it is impossible to isolate why a certain cost was incurred. In the litigation context, for example, a state may "agree" to make certain modifications that it was already planning to undertake; it may be generally ordered to undertake certain commitments, the specifics of which are left to the state agency; or it may resolve (as is the case in *Hissom*) to re-direct spending from one area to another, at no additional cost. In each of these cases, it would be an endless and fruitless exercise to categorize some costs as being a "settlement" of a case, while the same expenditures, absent litigation, would clearly be allowable. Taking the position in the draft audit to its logical extreme, a State that settles an "*Olmstead*" suit to provide more community services to its Medicaid population could not claim any of the cost of those services as an allowable expense,

² The DAB decisions and interpretive materials addressed here all dealt with a previous formulation of the "fines and penalties" provision of OMB Circular A-87. The "Fines and Penalties" provision was amended in 1995 to change the description of unallowable payments from "Costs resulting from violations of [law]" to "Fines, penalties, damages, and other settlements resulting from violations of [law]" This change has not been explained nor subsequently interpreted, though based upon the definitions of the terms used, there is no reason to think that this amendment supports the OIG's broad reading. See 60 FR 26484-26507 (May 17, 1995)(adopting final revision), 58 FR 44212-44234 (August 19, 1993), and 53 FR 40352-40367 (October 12, 1988). If anything, the language of the regulation seems to have narrowed in order to clarify that the provision merely refers to penalty payments that resulted from litigation.

Mr. Gordon L. Sato
September 21, 2004
Page 5

while a State that provides those same services without being sued could continue to claim them. The position taken in the draft audit is not a reasonable interpretation of the language in the Circular, and the administrative costs associated with the Hissom Litigation should be recognized as allowable costs eligible for federal financial participation.

Thank you for your consideration and please feel free to contact me or my staff should you need any additional information.

Very truly yours,

A handwritten signature in cursive script that reads "Howard H. Hendrick".

Howard H. Hendrick
Director of Human Services

HH/rf
cc: Jim Hargrove