

Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Colorado Department
of Health Care and
Policy Financing
Docket No. A-06-6
Decision No. 2057

DATE: December 15, 2006

DECISION

The Colorado Department of Health Care Policy and Financing (Colorado or State) appealed the determination of the Centers for Medicare & Medicaid Services (CMS) disallowing \$11,028,368 in Medicaid federal financial participation (FFP). Colorado claimed this FFP as a retroactive adjustment to claims for costs of school-based services provided by local school districts between December 30, 2002 and December 29, 2004. In the course of the appeal, CMS reduced the disallowance to \$10,438,941.

We uphold CMS's determination that Colorado's claim was not made in accordance with the provisions of Colorado's approved Medicaid State plan (State plan), as Colorado had historically interpreted and implemented those provisions. We agree with CMS that Colorado claimed this FFP pursuant to rates calculated under a revised methodology that "constituted a significant and substantial change" from the methodology that Colorado originally submitted to CMS in implementing its State plan and that it had historically used in administering its State plan. Additionally, we uphold CMS's determination that the State plan did not authorize the type of retrospective recalculation of rates Colorado performed here. We sustain the disallowance as reduced by CMS.

Law and regulations

Title XIX of the Social Security Act (Act), known as Medicaid, provides for joint federal and state financing of medical assistance for certain needy persons. See also 42 **C.F.R.** § 430.0. States which establish a Medicaid program are required to submit a State plan for that program that meets all federal

requirements. Section 1902 of the Act. To receive FFP, a state must claim the costs of medical assistance in accordance with its approved State plan. Section 1903(a) of the Act; 42 C.F.R.

§ 430.10. States may seek reimbursement only for rates determined in accordance with the State plan that is in effect. Louisiana Dept. of Health and Hospitals, DAB No. 1542, at 2, 22 (1995); New Jersey Dept. of Human Services, DAB No. 1143, at 5 (1990).

"The State plan contains all information necessary for [CMS] to determine whether the plan can be approved to serve as the basis for Federal financial participation (FFP) in the State program."

42 C.F.R. § 430.10; see also Virginia Dept. of Medical Assistance Services, DAB No. 1838 (2002). The State plan must provide that it will be amended whenever necessary to reflect "material changes in State law, organization, or policy, or in the State's operation of the Medicaid program." 42 C.F.R. § 430.12(c) (ii).

Generally, the Board gives deference to a state's interpretation of its own State plan, so long as that interpretation is an official interpretation and is reasonable in light of the language of the plan as a whole and the applicable federal requirements. Missouri Dept. of Social Services, DAB No. 1412 (1993); South Dakota Dept. of Social Services, DAB No. 934 (1988). However, the Board has held that states must follow the methods and standards set out in their State plans, and may not change their plans unilaterally. New Hampshire Dept. of Health and Human Services, DAB No. 1862 (2003); California Dept. of Health Services, DAB No. 1474 (1994); California Dept. of Health Services, DAB No. 1007 (1989).

Background

In 1997, CMS approved State Plan Amendment (SPA) 95-003, Attachment 4.19(b), establishing Colorado's School Health Services Program for Medicaid-covered services provided in schools. State Att. B. Local school districts fund the state share for this program through certified public expenditures by certifying their costs as representing expenditures eligible for Medicaid FFP under the School Health Services Program. **42 C.F.R. § 433.51; CMS Ex. 6. Historically, Colorado has deducted an administrative fee from the resulting FFP and paid the remainder to the school districts. CMS Ex. 16, at 1.**

SPA 95-003 sets forth Colorado's "Reimbursement Methodology for School-Based Health and Related Services." Paragraph 1 provides:

Overall Methods and Standards

Reimbursement rates shall be on a fee for service basis.

The Department [of Health Care Policy and Financing] will pay average statewide rates that are developed according to Department formula. Rates are based on the costs of providing school health and related services by participating providers. With the exception of the school health encounter (partial ESPDT screen), costs for school-based health services shall be calculated on an encounter basis, aggregated in 15-minute increments.

Time studies and/or audits will be performed periodically to help ensure encounter rates do not exceed costs incurred.

State Att. B.

SPA 95-003 became effective July 1, 1997. CMS Ex. 7, at 5. In a letter dated September 10, 1999, Colorado requested CMS's approval of its "method for establishing reimbursement rates for the School-Based Health Services Program" and represented that it would pay "average statewide rates according to the following formula." State Att. C, at 1. The methodology set forth in the letter provided:

$$\begin{aligned} &\text{Average Statewide Rate} = \\ &X + (X \cdot \text{*CDE unrestricted indirect rate}) \\ &+ (X \cdot \text{direct support rate}) \\ &+ (X \cdot \text{administration support rate}) \\ &\quad \text{*Colorado Department of Education} \end{aligned}$$

Where X = Average salary and fringe

Id. (state copy of letter); see also CMS Ex. 5 (CMS copy of letter).

The letter also explained how Colorado would establish an indirect rate, a direct support rate, and an administrative support rate.

A handwritten annotation on the CMS copy of the letter states:

... Called Barbara Ramsey [of Colorado] on 9-24-99 - Said this material would not be something we [CMS] would approve & that it needed to be in the State Plan. Asked

if she needed a formal letter to that affect [sic] & she said "no." – She knew it has to be in the State Plan for approval. This letter does tell us what CO is & has been doing. Betty S.

CMS Ex. 5, at 1.

Colorado does not dispute that the conversation memorialized in this annotation occurred. Nothing in the record indicates that Colorado resubmitted the methodology as a State plan amendment, as instructed by CMS. However, Colorado does not dispute that it filed claims and was reimbursed by CMS pursuant to this methodology or that this methodology reflected Colorado's interpretation of SPA-95-003.¹

In 2002, Colorado entered into "a contingency-based contract with Public Consulting Group, Inc. (PCG) to provide revenue maximization services to the State of Colorado." CMS Ex. 6, at 1. One of the projects undertaken by PCG was "a rate adjustment for school-based Medicaid claiming." *Id.* Based on PCG and Colorado's review of Colorado's rate calculation methodology, Colorado concluded that "the reimbursement rates should be updated in order to reflect, more accurately, the actual cost of providing school health and related services by participating school district providers." CMS Ex. 7, at 2. Colorado then

¹ **Nothing in the record indicates whether CMS considered disallowing claims for FFP based on this methodology on the ground that it was not submitted as a plan amendment. However, the issue in this appeal is not whether CMS could have disallowed FFP claimed under this methodology but, rather, whether CMS can rely on Colorado's statement and use of that methodology to claim FFP under SPA 95-003 as evidencing Colorado's historic interpretation of that plan amendment. As discussed in this decision, it can.**

modified its rate calculation methodology; the revised methodology resulted in an average rate increase of over 67%. CMS Ex. 6, at 1. Using the revised methodology, Colorado "completed a retroactive recalculation of amounts paid" in 2003 and 2004 (*id.*) and filed a retroactive claim for the FFP at issue, \$11,028,368.

On September 2, 2005, CMS issued a notice of disallowance of \$11,028,368 "based on a retroactive change in the methodology for computing rates for school-based service providers for the period, December 30, 2002 to December 29, 2004."² State Att. A. CMS stated -

CMS has concluded that these claims are not consistent with the provisions of the approved State plan, as the State itself has interpreted those provisions. . . . The claims at issue were calculated using a different methodology which constituted a significant and substantial change. This new methodology is not described in the State plan, and cannot be effective without submitting for approval an amendment to the State plan as required by 42 C.F.R. § 430.12(c), 42 C.F.R. § 430.20(b)(2) and 42 C.F.R. § 447.201, and providing prior public notice in accordance with 42 C.F.R. § 447.205. **Moreover, the current approved State plan provision does not provide for interim rate payments, or adjustment of payment amounts once finally determined.**

Id.

Colorado argues that the claim reflects correction of errors rather than a change in its previous rate calculation

² Beginning at least in the fall of 2004, CMS and Colorado had repeated interactions about Colorado's intention to prospectively and retrospectively increase its rates for school-based services. See CMS Exs. 8-14. From the beginning, CMS instructed Colorado that it could not modify its methodology for calculating such rates without submitting a plan amendment and that the effective date of a revised methodology would not be earlier than the first day of the quarter in which the amendment was submitted. CMS Ex. 8. CMS also informed Colorado that its existing State plan did not describe in sufficient detail the method by which Colorado calculated payments to the school districts. Id.

methodology. State Br. at 6. As Attachment D to its brief, Colorado submitted a declaration by the Director of the Colorado Medical Assistance Office (Director) describing six categories of "errors" corrected by Colorado in the course of calculating this claim. In its response to the appeal, CMS states that it accepts the amounts identified in three of the six (categories 1, 2, and 6) as representing "corrections to original calculations" and is, thus, reducing the amount in dispute from \$11,028,368 to \$10,438,941. CMS Br. at 6. However, CMS states that it does not consider the amounts identified in the remaining three categories to represent correction of errors to prior calculations but rather changes in rate methodology. Id. at 7.

Analysis

For the reasons discussed below, we sustain CMS's disallowance of this claim, as adjusted by CMS on appeal.

1. These costs are not allowable because they were not claimed in accordance with the provisions of Colorado's approved State plan, as Colorado itself interpreted those provisions.

Colorado claims FFP for school-based services provided by school districts pursuant to SPA 95-003. Under SPA 95-003, rates are paid on a fee for service basis; rates are average statewide rates developed pursuant to a "Department formula"; and rates "are based on the costs of providing school health and related services by participating providers." State Att. B. While SPA 95-003 does not set forth a formula or methodology for calculating rates,³ Colorado submitted a methodology to CMS subsequent to CMS's approval of the plan amendment. CMS Ex. 5. In this proceeding, Colorado characterizes that methodology as the basis for its "original rate calculations." State Br. at 3.

Using that methodology and the resulting rates, Colorado claimed FFP, accepted payment of its claim from CMS, CMS Ex. 7, at 7, and, after deducting an administrative fee, paid the amount of the FFP claimed to participating school districts, CMS Ex. 16, at 1. Thus, this original methodology and Colorado's use of the

³ The parties and documents sometimes refer to the rate calculation system submitted by Colorado to CMS in 1999 as a "formula," and at other times they refer to it as a "methodology." We use the term "methodology" throughout the decision for the sake of consistency when discussing the rate calculation system.

methodology through 2004 are evidence of Colorado's historical interpretation and application of SPA 95-03 and the rates payable under that plan.

Subsequently, Colorado revised the original methodology and claimed retroactive FFP based on application of the revised methodology. While Colorado characterizes the revisions to its claiming processes as "corrections," we conclude that the revisions resulting in this disallowance constitute material modifications to the rate calculation methodology itself, rather than correction of errors in the application of the methodology.⁴ Below we give an overview of Colorado's rate calculation methodology and examples of changes it made to the methodology.

Colorado's methodology is based on four types of costs: direct service costs (also referred to as salary and benefits), direct support costs, administrative support costs (also referred to as direct administrative costs), and indirect costs. Direct service costs represent the "hourly cost of clinician time spent for the provision of a health service." CMS Ex. 10, at 2. They include "the allowable salary and wages [and] fringe benefit costs." Id. Direct support costs "represent activities [that are] related to the provision of direct services but that are not part of the face to face encounter." Id. Examples include planning for a therapy session or travel time of therapists to and from sessions. Administrative support costs are common costs, such as utilities, communications, printing, etc., that can be allocated to the provision of Medicaid-covered health services. Id. at 3. Indirect costs are costs that are "not readily assigned to one cost objective." Id. at 6. Examples of indirect costs include data processing, accounting, and personnel.

Under the revised methodology, Colorado maintained these cost types but made material changes to the treatment of direct support costs and administrative support costs and to the order of operations. Below we discuss the changes identified by the parties on appeal.

As acknowledged in the Director's declaration, State Attachment D, at 3, ¶ (4, Colorado modified the way it calculated its direct

⁴ CMS agrees that some of the changes were corrections of errors in applying the prior methodology and allowed these costs. CMS Br. at 5-6. Later in this decision we discuss these corrections and compare them to changes CMS treated as revisions of the methodology.

support costs, i.e., its costs for "activities related to the provision of direct services . . . that are not part of the face to face encounter." CMS Ex. 10, at 2.

- One modification involved the inclusion of a kind of cost that had not been previously included in its direct support costs. CMS Ex. 14, at 3. This new cost represents "the amount of allowable indirect (general administration) time allocable to each unit of service", id., or, as stated by the Director, the "administrative activities related to the actual treatment time." (State Att. D, at 3, ¶ (4). Colorado describes this cost as representing "the proportional percentage of general administrative time allocated to the delivery of XIX services (paid lunch, breaks, paid leave, staff meetings, etc.)." CMS Ex. 10, at 3; compare Colorado's original mathematical formula for calculating the direct support rate at CMS Ex. 10, at 50 with the revised formula at CMS Ex. 10, at 91, which identifies the addition of this time as "total indirect time."
- Additionally, in the revised methodology, Colorado created two distinct direct support rates: one for direct medical (or clinical) services and one for Individualized Education Plan (IEP) and Targeted Case Management (TCM) services. CMS Ex. 7, at 8-9. Previously, Colorado treated time spent on preparing to deliver services to patients or on following up service delivery as "uniform for all activities." State Att. D, at 3, ¶ (4).
- Using the revised methodology, Colorado determined that the appropriate direct support rate for clinician services was 41.57%. CMS Ex. 7, at 9; CMS Ex. 10, at 65. It determined that the appropriate support rate for IEP and TCM services was 13.45%. CMS Ex. 7, at 9; CMS Ex. 10, at 72, 76. Under the original methodology, Colorado determined that the appropriate direct support rate for all types of services was 11.29%. CMS Ex. 10, at 24.

Colorado states that the increase attributable to the changes in its direct support rate methodology was \$3,888,073. State Att. D, at 3, ¶ (4).

As acknowledged in the Director's declaration, Colorado also modified the way it calculated its administrative support rate. State Att. D, at 3, ¶ (5. **One modification involved the inclusion of costs that had not been previously included, such as "Capital, Debt Services, and other OMB A-87 allowable costs." CMS Ex. 7, at 2. Another modification was the development of cost pools based on data reported by school districts to the Department of Education under a uniform chart of accounts. State Att. D, at 3, ¶ (5; CMS Exs. 7, at 9, and 10, at 3. The previous methodology was based on a survey completed in 1999-2000, CMS Ex. 14, at 3 and State Att. C, at 2, and applied a single administrative support rate of 18% to all salary/benefit costs, CMS Ex. 10, at 51-52. The revised methodology uses multiple "service specific Administrative Rates." *Id.* Examples of such service specific rates for 2003-2004 are 51.22% for audiology, 42.62% for counseling - individual, and 50.13% for nursing - individual. CMS Ex. 10, at 66. Colorado states that the change in its administrative support rate methodology resulted in a \$5,596,385 increase in FFP. State Att. D, at 3, ¶ (5.**

Finally, as acknowledged in the Director's declaration, Colorado modified the order of operations in the revised methodology. State Att. D, at 3, ¶ 3. This change enlarged the cost base against which the administrative support rate and indirect cost rate are applied. In the original methodology, the administrative support rate and the indirect cost rate were each applied only to salary and benefits to get the direct administrative costs and indirect costs respectively.⁵ CMS Ex. 10, at 12 (A copy of a chart submitted by Colorado to CMS showing the original order of operations and the revised order of operations is attached to the decision as Board Appendix A.) In the revised methodology, the administrative support rate is applied to salary and benefits plus the direct support costs to obtain the direct administrative costs, and the indirect cost rate is then applied to salary and benefits plus the direct support costs plus the direct administrative costs to get the total school health services costs. *Id.* Colorado states that **the increase attributable to the** modification of the order of operations was \$954,483 in FFP. State Att. D, at 3, ¶ (3.

These changes illustrate that the FFP claimed retroactively is based on a methodology that is not described in the State plan

⁵ **The direct support rate was also applied to salary and benefits to get the direct support costs. This has not changed. CMS Ex. 10, at 12.**

and is not consistent with Colorado's interpretation of the plan, as evidenced by Colorado's historic practice in administering it, that is, the methodology previously used to claim FFP. CMS reasonably concluded that the costs claimed pursuant to the revised methodology are not allowable because the "claims are not consistent with the provisions of the approved State plan, as the State itself has interpreted those provisions." State Att. A. CMS also reasonably concluded that, under section 430.12(c)(ii), these revisions constituted "material changes in State . . . policy, or in the state's operation of the Medicaid program" and required amendment of the State plan to become effective. Id.

Colorado argues that the Board should defer to the interpretation of the State plan that it advances here, that is, its revised methodology. State Br. at 2. We find there is no basis for such deference in this case. Where a State plan is ambiguous, the Board has generally deferred to that state's interpretation of its plan provided the state's interpretation is reasonable in light of the purpose of the provision and program requirements, gives effect to the language of the plan as a whole, and is supported by evidence of consistent administrative practice. South Dakota, DAB No. 934, at 4; North Carolina Dept. of Human Resources, DAB No. 1631, at 29 (1997); California, DAB No. 1474, at 3. SPA 95-003 is ambiguous since it does not specify a method for calculating rates. However, no deference is due to the interpretation Colorado advances here because it is inconsistent with Colorado's prior interpretation as evidenced by its letter of September 10, 1999 and its prior administrative practice. See New Hampshire, DAB No. 1862, at 20-22 (Board refused to defer to New Hampshire's interpretation that its State plan allowed subsequent payment after the "final" payment permitted by the plan, where the plan did not provide for subsequent payment and there was no showing New Hampshire had ever previously interpreted its plan to permit such payment).

Colorado argues that the Board should conclude that its revised interpretation and revised methodology simply conform Colorado's rate calculation methodology to the requirements of the State plan. State Br. at 6, 7. Colorado relies on the plan phrase stating that "rates are based on the costs of providing school health and related services by participating providers." It argues that "the corrections resulted from an audit determination that provider costs were erroneously omitted from the rate formula in violation of the approved State plan." Id. at 6.

We reject this argument. The plan merely provides that "rates are based on the costs of providing school health and related services," and the original methodology did base the rates on

what Colorado determined those costs to be. That methodology, along with Colorado's administrative practice through 2004, reflected Colorado's interpretation of how rates should be calculated to reflect those costs. The revised methodology advances a new interpretation by including additional costs and changing some of the algebraic processes. Colorado offers no persuasive basis for concluding that its original methodology violated the state plan or that its revised methodology is required by the state plan. The fact that Colorado now seeks to redefine its methodology to capture additional costs or treat the previously captured costs differently does not make the original methodology invalid.⁶

⁶ In 2005, Colorado filed a State plan amendment (SPA 05-006), which, as described by CMS, appears to be based on the revised methodology. CMS Br. at 31, n.4. CMS is currently reviewing the amendment and questions the allowability of some of the costs the new methodology proposes to capture. Id. However, even if CMS ultimately approves the revised methodology in some form, that methodology was not the interpretation of the plan in effect during 2003 or 2004 and cannot be used to claim costs for those years.

Colorado also argues that its plan "requires the correction of erroneously calculated rates as determined upon an audit review."

State Br. at 3 (emphasis added). Colorado relies on the language in the plan stating that "[t]ime studies and/or audits will be performed periodically to help ensure encounter rates do not exceed costs incurred." State Br. at 3. Colorado asserts that this language authorizes upward adjustments of rates based on audits. Id. We disagree. The plan does not mention, much less require, upward adjustment of previously calculated rates to ensure that districts have been paid the actual costs of providing these services or even the actual average costs of these services.⁷ The phrase on which Colorado relies concerns reviews as to whether rates have exceeded costs; it protects Colorado and CMS from claims that exceed expenditures. The clause in no way implies that Colorado is required to review past claims to determine if the rates should be raised.⁸

⁷ Additionally, we note that Colorado's plan calls for paying "average statewide rates." State Att. B. Thus, the plan never contemplated paying individual districts their actual costs.

⁸ Colorado asserts that in the past it has modified its practices "to ensure greater accuracy of the data." State Br. at 3. It gives an example of shifting from collecting salary and benefits information on an annual basis to collecting such information on an hourly basis. This kind of change, however, is not a material change to the rate calculation methodology but

merely a change in the way the information for one factor in that methodology - salary and benefits - was gathered. Unlike the material changes at issue in this case, the information gathering shift described by Colorado did not change either the parameters of the cost factors or the order of operations in the original methodology.

Further, Colorado's practices in administering its plan demonstrate that Colorado does not construe the plan (or any other source of authority) to require it to make retroactive upward adjustments of rates to cover the actual costs of these services. Indeed, Colorado acknowledges that its **contract with the school districts expressly precludes such retroactive adjustments. The contract provides: "The [school district] shall be reimbursed by the Department, without retroactive adjustment, at the rates, and in such amount as may from time to time be specified by the Department pursuant to applicable federal and state statutes and regulations"** CMS Ex. 15, at 6 (emphasis added). Relying on this contractual language, Colorado has informed districts that the retroactive FFP at issue will go to the State's general fund because **"participating school districts have received all of the federal matching funds that were due to them under their contracts"** and that its contracts with districts **"do not provide for reimbursement to the schools based on retroactive rate adjustments."** CMS Ex. 6, at 1.⁹

⁹ In its Reply Brief, Colorado complains about CMS's reference to its intention to retain the FFP. State Reply Br. at 2. We consider this evidence relevant to Colorado's argument, as discussed above, that the State plan requires it to make retroactive adjustments to the rates. Further, we note that the

facts here raise a question about whether these retroactive rate adjustments were necessary and reasonable costs, as required by OMB Circular A-87, C.1.a.

Colorado cites CMS's modification of the disallowance to allow \$929,337 of the \$11,028,368 claimed and argues that there is no distinction between the costs CMS allowed and disallowed. Colorado concludes, therefore, that all claimed costs should be allowed. State Reply Br. at 2. We disagree. CMS allowed, as "corrections to original calculations," three of the six categories of changes described by the Colorado Director of the Medical Assistance Office, State Attachment D. The allowed costs plainly represent corrections to errors of a mathematical nature made in applying the original methodology. The first change involved correcting spreadsheet errors, specifically, an error in applying cell references in an Excel spreadsheet to the wrong fields in the spreadsheet. State Att. D, at 2, ¶ (1. The second change also involved correcting spreadsheet errors caused by mistakenly including six districts that did not report indirect cost rates in calculating that rate. Id. at 3, ¶ (2 The third change involved correction of faulty data, which resulted in overstated costs. Id. at 3, ¶ (6. We agree with CMS that these changes are corrections, as that term is customarily understood, of mistakes Colorado made applying its original methodology. In contrast, the three other categories of costs, which CMS continues to disallow, involve material changes to the processes by which Colorado calculated the rates.¹⁰

Colorado argues that, under its original methodology, applying the indirect cost rate to salary and benefit costs rather than all direct costs was "mathematically wrong." State Br. at 5, relying on the Director's declaration. Similarly, in its reply

¹⁰ Colorado also argues that -

when CMS publishes correction notices in the Federal Register concerning various errors it has made in Medicare prospective payment rate calculations, it states in the Federal Register that such corrections do not require notice-and-comment rule making because corrections are not a change in payment methodology.

State Br. at 7.

We question whether this is an appropriate analogy. Nevertheless, by allowing correction of mathematical errors in Colorado's application of its original formula, CMS did permit correction of Colorado's rate calculation errors, reasonably distinguishing them from Colorado's changes in methodology.

brief, Colorado asserts that CMS is embracing "bad math" by refusing to allow Colorado to revise the order of operations for calculating administrative support costs and indirect costs State Reply at 3.

We reject this argument for several reasons.

- Since Colorado adopted the original order of operations and then used it for a number of years, it is reasonable to presume that Colorado had reason to believe the order captured the costs Colorado intended it to capture. The fact that Colorado now seeks to revise the order in the context of redesigning its methodology does not rebut this presumption. States regularly refine their claiming practices by amending State plans and cost allocation plans to capture costs that were not captured under prior practices. This phenomenon does not make the prior practices "mathematically wrong."
- Neither the Director's declaration nor Colorado's briefs offer any clear explanation for Colorado's assertion that the original order of operations was "mathematically wrong." Additionally, some of Colorado's assertions on appeal seem inconsistent with representations made to CMS in the course of the pre-disallowance discussion between Colorado and CMS. We note that the parenthetical in the Director's declaration describing the "allowable direct costs" for purposes of the indirect cost calculation ("salary and benefits for treatment time spent with patients as well as costs for time spent away from patients on preparing to deliver a service, recording the delivery of a service, etc.") does not specify that direct administrative costs are included in allowable direct costs, yet Colorado seeks to have the average indirect cost rate applied to the direct administrative costs. CMS Ex. 10, at 12; CMS Ex. 14, at 2.
- Even if we assume Colorado is seeking to invoke OMB Circular A-87 cost principles (though Colorado does not refer to any specific A-87 principle here), Colorado has failed to show that the original order of operations somehow transgressed these principles. Under OMB A-87, an indirect cost rate is "the ratio (expressed as a percentage) of the indirect costs to a direct cost

base."¹¹ OMB A-87, Att. E, ¶ B.1. The resulting indirect rate is then customarily applied to a direct costs base comprised of the same cost elements that were in the base used to calculate the indirect cost rate. The indirect cost rate should not be applied to costs that were not included in the direct cost base. Here, the original methodology applied the indirect cost rate only to salaries and benefits, raising a presumption that Colorado originally included only salaries and benefits in the direct cost base used to calculate the indirect cost rates. In order to show that not applying the average indirect cost rate to direct support costs and direct administrative costs (in addition to salary and benefits) was somehow inconsistent with the OMB principles we address above, Colorado would need to prove that the original methodology used to calculate the school districts' unrestricted indirect cost rates included direct support costs and direct administrative costs in the direct cost base. Colorado's evidence is insufficient to show this.¹²

¹¹ For this purpose, "base" means "the accumulated direct costs (normally either total direct salaries and wages or total direct costs exclusive of any extraordinary or distorting expenditures) used to distribute indirect costs to individual Federal awards." OMB A-87, Att. C, ¶ B.4.

¹² The Director's declaration arguably could be read as implying that all direct costs were included in the base for each school district's non-restricted rate, but she does not specifically state that she has any personal knowledge of how the indirect cost rates were calculated for each school district. Moreover, the documents Colorado submitted to CMS show that the nonrestricted rates for the school districts varied substantially, raising a question about whether a consistent methodology was used. See CMS Ex. 10, at 53. Also, the underlying calculations, submitted for only one school district, indicate that some direct costs (such as capital costs) were excluded from the base used to calculate the indirect cost rate. CMS Ex. 10, at 13. The evidence for this school district also indicates that the non-restricted rate was "not endorsed" by the Colorado Department of Education. Id. at 15. On the whole, this evidence, when carefully examined, undercuts Colorado's assertion that the rates were "approved" and included only allowable costs.

Since it is reasonable to presume that Colorado had a mathematically correct rationale for its original order of operations, and since Colorado makes no clear argument as to why the original order is "mathematically wrong" and cites no supporting evidence, we conclude that Colorado has failed to provide any basis for concluding that the original order of operations should be treated as "mathematically wrong."

Colorado also cites Louisiana, DAB No. 1542, and argues that, unlike the claim in Louisiana, "none of [these] audit corrections entailed allowing new types of costs that the State had initially elected to omit from the cost base used to set rates." State Br. at 7. In Louisiana, the Board held that the State could not change its rate setting methodology retroactively to include costs in that methodology that it had chosen to omit. The Board agreed with CMS that Louisiana "needed to submit a plan amendment if it wished to change its rates to reflect a different methodology to recognize costs." Louisiana, DAB No. 1542, at 22. Colorado tries to distinguish the changes it made from those disallowed in Louisiana, but the record does not support any such distinction. Colorado's revisions to its methodology do add new types of costs. For example, Colorado added "Capital, Debt Services, and other OMB A-87 allowable costs" to its administrative support costs. CMS Ex. 7, at 2, see also, CMS Ex. 7, at 9; CMS Ex. 10, at 5. Additionally, Colorado added "the proportional percentage of general administrative time allocated to the delivery of XIX services (paid lunch, breaks, paid leave, staff meetings, etc)" to its direct support costs. CMS Ex. 10, at 3. Colorado could have included these costs in its original methodology but did not. Like Louisiana, it must submit a plan amendment to include them now.

2. These costs are not allowable because Colorado's State plan does not provide for retrospective adjustments of payment amounts.

CMS also disallowed these costs on the ground that Colorado's State plan does not provide for "adjustment of payment amounts once finally determined." State Att. A. CMS filed a declaration by the Branch Manager for the State Program Branch with the Division of Medicaid and Children's Health of Region VIII. He stated, based on his knowledge of Medicaid Reimbursement systems and of Colorado's system and practices, that Colorado's system "is not a prospective cost-based payment system with interim or retroactive rate adjustments." CMS Ex. 17, at 2. Rather, he asserted --

The Colorado School based reimbursement system is a uniform state-wide fixed fee paid to all the school districts. The fixed fee was based in part on the average cost incurred by some school districts for a past period. The State's Medicaid Agency's contract with contracting school districts provides that the school districts shall be reimbursed by the Department, without retrospective adjustment, at the rates specified by the State Medicaid Agency.

Id.

This testimony is consistent with the exhibits discussed above: Colorado's contract with the school districts, which expressly provides **that each district "shall be reimbursed by the Department, without retroactive adjustment, at the rates . . . specified by the Department," CMS Ex. 15, at 44, and Colorado's statement to the districts that they would not receive any of the retroactive FFP because they "have received all of the federal matching funds that were due to them under their contracts," which "do not provide for reimbursement to the schools based on retroactive rate adjustments," CMS Ex. 6, at 1.**

Colorado offers no testimony to rebut the CMS declaration. Colorado does rely on the language in its plan that "[t]ime studies and/or audits will be performed periodically to help ensure encounter rates do not exceed costs incurred." State Br. at 3. However, as discussed above, this language protects the State and CMS from claims that exceed expenditures. Furthermore, Colorado offered no evidence to show that it ever interpreted this language to require or authorize retroactive adjustment of rates. In its Reply Brief, Colorado also relies on **the following sentence in a 1999 letter to CMS: "An audit will determine the actual costs for each district and a reconciliation will be made for any variances between payments and actual costs." State Reply Br. at 4-5 citing State Att. C. Colorado argues "the DAB should consider that statement to be contemporaneous evidence of State intent." Id. at 5. The letter to which Colorado refers was not submitted contemporaneously with SPA-95-003, but rather, more than two years later. Thus, CMS is not required to regard the statement as contemporaneous evidence of Colorado's interpretation of its State plan. Further, if Colorado is arguing that this sentence proves that retroactive rate adjustment pursuant to audits is part of its historic administrative practice, that argument is unsupportable. The record is devoid of any evidence (and Colorado does not argue)**

that it engaged in routine audits or retrospective compensation of districts for actual costs. Also, such a practice is contrary to the terms of the State plan, which states that the purpose of the audits provided for in the plan is to assure that encounter rates do not exceed costs incurred, not to allow adjustments for actual costs. Furthermore, as stated above, Colorado's contracts with its school districts did not allow retroactive adjustments.

Based on the record, we conclude that neither the language of SPA 95-003 nor Colorado's prior interpretation, as demonstrated by its administrative practice, authorizes retrospectively modifying the rates and amounts paid for school-based services.

Colorado cites the following cases addressing retrospective adjustment to costs claimed under prospective rate systems: South Dakota Dept. of Social Servies, DAB No. 934 (1988); New Hampshire, DAB No. 1862; and Alaska, DAB No. 1452. These cases do not support Colorado's arguments for two reasons.

First, the cases are all consistent with the principle that retroactive adjustments to reflect the actual costs of providing services are not generally allowed in prospective rate systems.¹³ Arkansas Dept. of Human Services, DAB No. 357 (1982); Illinois Dept. of Public Aid, DAB No. 467 (1983). This general rule

¹³ Questions arise about retrospective adjustments in prospective rate systems because "[a] distinguishing characteristic of prospective systems is that there needs to be no retrospective adjustment to reflect the actual costs of providing services during the rate period." Alaska Dept. of Health and Social Services, DAB No. 1452, at 9-10 (1993). In contrast, in a retrospective rate system, "interim" rates are compared to the actual costs for the cost reporting year in question and adjusted to reflect those costs.

supports CMS, not Colorado, regardless of whether Colorado's system is viewed as a fixed rate system or a prospective rate system.

Second, while the cases cited by Colorado recognize exceptions to this general rule in prospective rate systems, the facts here do not fall within any of these exceptions. These cases address retrospective adjustment to costs claimed pursuant to a prospective system to correct mistakes in applying the system or to reflect more accurate data consistent with the State plan. See South Dakota Dept. of Social Services, DAB No. 934, at 18 (1988) (recognizing that "[a]djustments for erroneous cost or statistical reporting are consistent with a prospective-only system" but finding no such errors); New Hampshire, DAB No. 1862, at 22 (stating that while the Board was upholding the disallowance of FFP claimed based on adoption of a new methodology not specified in the approved State plan, it was not holding "that a state is precluded from making routine upward or downward adjustment to prior period payment to reflect more accurate data consistent with the state plan") (emphasis added); and Alaska, DAB No. 1452, at 10 (noting that Alaska had presented no authority to support the proposition that there is an "inherent prohibition on audit-based adjustments to correct errors that occur in setting prospective rates" and finding such a proposition inconsistent with the Board's discussion of the issue in South Dakota). In this case, CMS allowed Colorado to make these types of corrections when CMS reduced the disallowance to account for mathematical errors Colorado made in applying its original methodology and for misreported costs.¹⁴ As discussed in the prior section, however, the remaining disallowance involves claims that resulted not from correction of such errors but from revising the methodology by which the rates were calculated and applying that methodology. This is not the type of retrospective adjustment contemplated by these cases stating

¹⁴ Colorado also cited South Carolina Dept. of Health and Human Services, DAB No. 1602, (1996), pointing out that CMS allowed a 1994 adjustment to 1992 payments in a prospective rate system because CMS determined that the "additional payment was a true adjustment that was necessitated by a documented accounting error." State Br. at 4 citing CMS's brief as quoted in South Carolina, DAB No. 1602, at 4. As explained above, in this case CMS did allow adjustments "necessitated by documented accounting error." The remaining disallowance does not involve documented accounting errors.

the exception to the rule that retroactive adjustments to reflect the actual costs of providing services are not generally allowed in prospective rate systems.

In its reply brief, Colorado cites New York Dept. of Social Services, DAB No. 151 (1981), asserting that there the Board allowed "corrections made to reflect actual instead of estimated costs under a state plan which used a fixed rate system." State Reply Br. at 4. New York is legally and factually inapposite. The case is legally inapposite because the Board's analysis in New York does not focus at all on the differences between prospective and retrospective rate-setting that the Board has addressed in the line of subsequent cases, such as Illinois Dept. of Public Aid, cited by the parties and relied on by the Board in the instant decision. New York is also factually different in material respects. New York involved retroactive amendments to the State's fee schedule for public ICF/MR services under a state statutory mandate that the fees reflect the actual costs of those services (including care, treatment, maintenance, overhead and administration) and assure maximum allowable recovery of the costs. CMS, the Board noted, did not dispute that the fee schedule was designed originally to capture the actual costs incurred, and this also was supported by the testimony of the state's witness and the statutory requirements to maximize recovery of allowable costs. Based on these facts, the Board concluded, "[I]t would be illogical to assume that the State would deliberately set up a reimbursement methodology that would not capture all possible allowable costs." DAB No. 151, at 7. Colorado has not cited any statutory mandate to capture the actual costs of the services at issue here or to maximize allowable costs. Unlike New York, Colorado is not seeking to recover costs it was obligated by law to incur. Neither does it intend to pay the claimed FFP to the school districts that did incur the costs.

Conclusion

For the reasons explained above, we sustain the disallowance.

Judith A. Ballard

Leslie A. Sussan

Sheila A. Hegy
Presiding Board Member

Board Appendix A
Attachment A
Original Calculation Cost Pool Application