

**Department of Health and Human Services**  
**DEPARTMENTAL APPEALS BOARD**  
**Appellate Division**

West Virginia Department of Health & Human Resources  
Docket No. A-10-44  
Decision No. 2365  
March 14, 2011

**DECISION**

The West Virginia Department of Health & Human Resources, Bureau for Medical Services (West Virginia or State) appeals a determination by the Centers for Medicare & Medicaid Services (CMS) to disallow \$2,298,329 in federal financial participation (FFP) claimed under title XIX of the Social Security Act (Act). The disallowed FFP represents the federal share of certain Medicaid expenditures made by West Virginia for school-based health services (SBHS) from October 1, 2000 through June 30, 2001. CMS issued the disallowance on the ground that West Virginia's FFP claim for those expenditures was filed beyond the applicable two-year period established by section 1132(a) of the Act, 42 U.S.C. § 1320b-2(a), and did not qualify for the exception to the two-year limit for an "adjustment to prior year costs" found in section 1132(a)(2), 42 U.S.C. § 1320b-2(a)(2).

For the reasons stated below, we sustain the disallowance because it is undisputed that the relevant FFP claim was filed outside the two-year filing period established by section 1132(a) and because we conclude that the claim was not based on an adjustment to prior year costs. The exception to the two-year filing limit for adjustments to prior year costs is intended to cover unforeseen and unavoidable adjustments to a state's payment rate for Medicaid-covered services in order to account for differences between a final rate determined using actual allowable costs incurred in providing the services, and an interim rate based on estimated costs relating to those services. Although West Virginia's state Medicaid plan provided for interim payments that "must be cost settled on an annual basis," West Virginia did not show that the adjustments at issue here were made in accordance with a cost settlement process adopted by the state for retroactively adjusting payment amounts for SBHS. Moreover, the adjustment here – which was made to account for certain operating and indirect costs of providing SBHS that were not included in the interim rate – was neither unforeseen nor unavoidable. The record shows that West Virginia knew about the cost categories for operating and indirect costs when calculating its interim SBHS rates for the quarters in question, and there is no evidence that the State mistakenly omitted those costs in calculating those rates.

## Legal Background

The federal Medicaid statute, title XIX of the Act, authorizes a program that furnishes medical assistance to low-income individuals and families. Act § 1901. The program is jointly financed by the federal and state governments and administered by the states. Act § 1903; 42 C.F.R. § 430.0. Each state administers its Medicaid program in accordance with broad federal requirements and the terms of its “plan for medical assistance,” which must be approved by CMS on behalf of the Secretary of Health and Human Services (Secretary). Act § 1902; 42 C.F.R. § 430.10-430.16. The state plan must specify the medical or health-related services covered under the state’s Medicaid program. *See* Act § 1902; 42 C.F.R. 430.10. A state with an approved Medicaid plan is eligible to receive federal matching funds, also known as “federal financial participation” (FFP), for a percentage of the Medicaid program expenditures it makes in accordance with the state plan. Act § 1903; 42 C.F.R. §§ 433.10(a), 433.15(a). Medicaid FFP is distributed in quarterly grant awards. *Id.* § 430.30(a)(1).

Section 1132(a) of the Act, which applies to Medicaid and various other programs administered by the Secretary, provides that the federal government will reimburse a state for a program expenditure only if the state files a reimbursement claim within two years after the quarter in which the expenditure was made, unless certain exceptions apply. Section 1132(a) further states that the two-year filing requirement “shall not be applied so as to deny payment with respect to any expenditure involving court-ordered retroactive payments or audit exceptions, or *adjustments to prior year costs.*” (Emphasis added).

The purpose of the timely claims requirement is to “ensure that states submit final reimbursement requests in a timely fashion so that HHS can plan its budget.” *Connecticut v. Schweiker*, 684 F.2d 979, 982 (D.C. Cir. 1982), *cert. denied*, 459 U.S. 1207 (1983). In light of this purpose, the Board has also stated that “the exceptions to the timely claims requirement are intended to cover only ‘extreme situations’ and do not apply to the ‘routine situation where a state simply did not get around to getting its data together in time to file a claim within the statutory requirements.’” *Maryland Dept. of Health and Mental Hygiene*, DAB No. 1909, at 4 (2004) (quoting *New York State Dept. of Social Services*, DAB No. 521, at 8 (1984), *aff’d*, *New York v. Sullivan*, No. 92 Civ. 2832 (LMM), 1993 WL 266616 (S.D.N.Y. Apr. 7, 1993)). Instead, the exceptions are intended to “take care of those cases where it would be patently unfair to a state to outlaw its claim merely because of the passage of time.” *Id.* (quoting *New York*, DAB No. 521, at 8).

The program expenditures for which West Virginia seeks reimbursement are payments by its Medicaid program to school districts for the health-related services the districts provide to Medicaid-eligible children. Those payments were purportedly made under a retrospective reimbursement system. Retrospective reimbursement is a “system in which payment is made [for a service] on the basis of a provisional rate set prospectively for an

accounting period, and in which payments may be retrospectively adjusted on the basis of the cost experience during the accounting period.” *Pennsylvania Dept. of Public Welfare*, DAB No. 703, at 3 (citing 42 C.F.R. § 447.272 (1979)). The provisional – or “interim” – rate often serves as the basis for an FFP claim for the accounting period (i.e., the calendar quarter) to which it is applied in order to determine the amount of payment for covered services. *See Maryland*, DAB No. 1909, at 4. Later, “[w]hen the actual costs for [the accounting] period become known,” the costs reflected in the interim rate is audited and, if necessary, the rate is retrospectively adjusted as part of a “cost settlement” process. *Id.* The Board has further explained that:

Of course, delays in determining the actual, allowable costs for the period may prevent a state from submitting a claim based on a final payment rate within two years after the quarter in which the state’s expenditures were made. When this occurs, the claim may, under appropriate circumstances, be treated as seeking an adjustment to prior year costs exempt from the two-year filing requirement.

*Id.*

### **Case Background**

During late 1998 and 1999, West Virginia, with the assistance of its contractor, Pacific Health Group (PHG), developed a Medicaid payment methodology for certain health and health-related services furnished by county-based school districts to Medicaid-eligible special education students. *See W. Va. Ex. 7* (Declaration of Richard Brennan (“Brennan Decl.”)) at 2 ¶ 5; CMS Ex. 3, at 4-5. The new payment methodology was designed to permit those school-based health services (SBHS) to be billed to West Virginia’s Medicaid program using a handful of “service codes,” each of which represented a category of school-based service. Brennan Decl. at 2 ¶ 5. The codes represented the following four categories of SBHS: (1) development and updating of individualized education plans (as they related to health assessment and planning); (2) personal care services; (3) specialized transportation; and (4) care coordination. CMS Ex. 3, at 6.

Once it defined the scope of the relevant service codes, West Virginia calculated standard, per-unit payment rates for the various services, rates that reflected the school districts’ costs of providing the services. *See Brennan Decl.* at 3 ¶ 6; CMS Ex. 3, at 5. When the service codes were conceived, there “was no existing, standardized format for cost reporting or identification, and no available historical cost experience” for the relevant services. Brennan Decl. at 3 ¶ 6. Consequently, PHG surveyed school districts in order to obtain relevant cost (and other) data. *Id.*; CMS Ex. 3, at 13, 19, 38. The cost data obtained by PHG’s survey quantified salaries and fringe benefits paid to school district employees who provided Medicaid-billable services to special education students during State Fiscal Year (SFY) 1999. CMS Ex. 3, at 19-24; CMS Ex. 5, at 3, 6. West

Virginia does not assert that PHG's survey included any attempt to obtain any other type of cost data, such as operating or other indirect costs. *See* Brennan Decl. at 3 ¶¶ 5-6; W. Va. Ex. 3 (Franco-Atkins Letter); CMS Ex. 3.

During the rate development process, West Virginia consulted with CMS, which sought assurance that payment rates for Medicaid-covered SBHS, both initially and as updated, would not cause SBHS expenditures to exceed actual, "total costs." Brennan Decl. at 3 ¶ 8.

In February 2000, PHG presented CMS with a document that outlined the results of its rate development work. CMS Ex. 3. In this document, entitled "Calculation of Final Rates for Special Education Medicaid-Reimbursable Services," PHG proposed per-unit payment rates for each of the four categories of school-based services mentioned above. *Id.* at 6. The proposed rates were calculated using the data obtained from PHG's cost survey. *Id.* at 3; CMS Ex. 5, at 6. In addition to explaining how the proposed SBHS rates were calculated, PHG estimated the amount of FFP that West Virginia would obtain based on those rates. CMS Ex. 3, at 6.

In March 2000, West Virginia proposed to amend its Medicaid state plan in order to implement the proposed payment methodology. CMS Ex. 4, at 1. CMS approved the amendment on May 12, 2000, designating it as State Plan Amendment (SPA) 00-01 with an effective date of January 1, 2000. *Id.* at 1, 3-7. With respect to each of the four new categories of billable school-based services, SPA 00-01 stated that payment to the service providers (i.e., the school districts) would be "fee-for service" and would initially reflect an "interim rate" "based on statewide historical costs" for the service. *Id.* at 5, 6. At CMS's insistence, the amendment incorporated the following language: "Costs not to exceed actual reasonable costs and must be cost settled on an annual basis." *Id.* at 1, 5, 6; Brennan Decl. at 3 ¶ 8. The State asserts, and CMS does not dispute, that SPA 00-01 sets forth a retrospective payment methodology under which the State would establish interim payment rates for SBHS based on historical costs and later conduct a "cost settlement" to determine the actual cost of providing those services. W. Va. Br. at 1-2.

Based on the payment rates developed by PHG and submitted to CMS in February 2000 (the "February 2000 SBHS rates"), West Virginia submitted FFP claims for SBHS expenditures during the three quarters from October 1, 2000 through June 30, 2001. *See* CMS Ex. 3, at 17; WV Br. at 2-4. These FFP claims were submitted within the two-year filing period established by section 1132(a) of the Act.

In 2002, West Virginia retained another consulting firm, Public Consulting Group (PCG). *See* CMS Ex. 5, at 6. In a report dated October 1, 2003, PCG proposed to increase the February 2000 SBHS rates to reflect certain "operating and indirect costs" incurred by school districts to provide the school-based services for which the State had already claimed FFP (based on February 2000 SBHS rates), asserting that the omission of those

costs from the original rate calculations had caused West Virginia to “understate the actual cost of providing services.” *See* CMS Ex. 5, at 3-4, 7-8. Some of the cost data supporting the proposed rate increases were obtained from West Virginia Education Information System (WVEIS), a management information system used by the State’s school districts to identify, track, and report costs. *See* CMS Ex. 5, at 4; Brennan Decl. at 5 ¶ 12. PCG obtained the published indirect cost rates as calculated by the West Virginia Department of Education for each school district. CMS Ex. 5, at 4. PCG also proposed to increase the February 2000 SBHS rates to reflect its finding that actual salary and fringe benefit costs for the period October 1, 2000 through June 30, 2001 were higher than previously estimated (based on the 1999 survey cost data). CMS Ex. 5, at 7.

In Medicaid expenditure reports for the quarters ending September 30, 2003 and June 30, 2005, West Virginia claimed \$4,055,229 in additional FFP for SBHS expenditures during the quarters between October 1, 2000 and June 30, 2001 based on the rate adjustments proposed by PCG. *See* CMS 1, at 8, 12; CMS Ex. 2, at 3. The additional FFP sought for that period represented the difference between the amount of Medicaid expenditures earlier claimed by West Virginia based on the February 2000 SBHS rates, and the amount of Medicaid expenditures calculated by West Virginia based on the retrospectively adjusted rates. *See* Brennan Decl. at 6 ¶ 16. It is undisputed that, with respect to the three calendar quarters at issue in this appeal, West Virginia submitted its supplemental FFP claim more than two years after the claimed SBHS expenditures were made.

At CMS’s request, the HHS Office of Inspector General (OIG) conducted an audit to determine whether West Virginia’s supplemental FFP claim for the three quarters between October 1, 2000 and June 30, 2001 met the definition of an “adjustment to prior year costs,” thus qualifying the claim for an exemption to the two-year filing requirement in section 1132(a). *See* CMS Ex. 1, at 14-16. As noted, the supplemental claim reflected two retrospective adjustments to West Virginia’s February 2000 SBHS rates: (1) an adjustment to account for salary and fringe benefit costs that were higher than previously estimated based on PHG’s fiscal year 1999 cost survey; and (2) inclusion of operating and indirect costs in the cost pool from which the SBHS rates were derived.

The OIG determined that the portion of the supplemental claim which “reflected the settlement of previously identified salary and fringe benefit costs” met the definition of an adjustment to prior year costs and therefore did not violate the two-year filing requirement. CMS Ex. 1, at 9, 15. The OIG found that the portion of the supplemental claim attributable to inclusion in the SBHS cost pool of school districts’ operating and indirect costs, however, did not meet the definition.<sup>1</sup> *Id.* at 14-15. Because the school

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<sup>1</sup> The operating and indirect costs were those for administration and data processing, supplies, rent, maintenance and repair, and capital and debt service. CMS Ex. 1, at 15.

districts' operating and indirect costs were not reflected in the initial FFP claims, said the OIG, they could not be regarded as costs "later determined to be greater than *originally claimed*" (45 C.F.R. § 95.4), and thus their inclusion in the supplemental FFP claim did not constitute an adjustment to prior year costs. *Id.* Rather, said the OIG, the inclusion of these "new cost components" in West Virginia's supplemental FFP claim "represented a new and separate request for Federal funding of previously unclaimed cost items." *Id.* at 15. Based on these findings, the OIG recommended that CMS disallow \$2,298,329 in FFP, an amount that constituted the federal share of the portion of the supplemental claim that reflected payment rate adjustments attributable to the addition of operating and indirect costs to the SBHS rate calculations. *Id.*

CMS concurred with the OIG's audit findings and, accordingly, disallowed \$2,298,329 in FFP for West Virginia's Medicaid program. CMS Ex. 2, at 3.

### **Analysis**

As an initial matter, it is undisputed that the challenged disallowance relates to an FFP claim that was not filed within two years after the quarter in which the claimed expenditures were made. Thus, the sole question before us is whether the disallowed claim – which reflects an adjustment to interim payment rates for SBHS to include the overhead and indirect costs of providing those services – qualifies as an exception to the two-year filing requirement for "any claim for an adjustment to prior year costs."<sup>2</sup>

For the reasons addressed below, we conclude that the outcome in this case is governed by our prior decisions, most notably *Kansas Department of Social and Rehabilitation Services*, DAB No. 2014 (2006) and *South Carolina State Health and Human Services Finance Commission*, DAB No. 943 (1988). In *Kansas*, the Board held that the adjustment-to-prior-year-cost exception did not apply. Finding the Board's prior decision in *South Carolina* both factually and legally on point,<sup>3</sup> the Board observed in *Kansas* that both cases dealt "with rate increases that resulted from the fact that a state deliberately did not include underlying costs of which it was aware either in its calculations of the interim rates for state hospitals or in cost settlements of those rates that it referred to as 'final.'" DAB No. 2014, at 12. Both the District Court and Fourth Circuit affirmed the Board's *South Carolina* decision, with the Fourth Circuit explaining that the exception

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<sup>2</sup> Accordingly, we do not address or express any opinion about whether operating and indirect costs related to the provision of SBHS would be allowable.

<sup>3</sup> In *South Carolina State Health and Human Services Finance Commission*, DAB No. 943 (1988), *aff'd*, *S.C. Health & Human Servs. Fin. Com'n v. Sullivan*, No. 88-1313-16 (D.S.C. July 17, 1989), *aff'd*, 915 F.2d 129 (4<sup>th</sup> Cir. 1990), the Board held that South Carolina's proposal to revise its final, closed cost reports to include costs a public hospital had deliberately omitted and which South Carolina chose not to include when calculating the interim rates did not qualify for the exception.

for adjustments to prior year costs was designed to accommodate costs that were unknown to the agency at the time it calculated the interim rate:

Since a retrospective rate system uses historical cost as a proxy for the actual cost of providing services, the interim billing rate most likely will not be for the exact amount of the actual current costs. As a result, a retrospective rate system *permits state agencies to file adjustments for costs which were unknown to the agency earlier and therefore not included in the provider's historical cost estimate*. This is the type of adjustment which the [Board] considers as an adjustment to prior year costs, and is related to the interim rate process because in such a process *unknown* costs are bound to arise for which state agencies should be compensated.

*South Carolina*, 915 F.2d 129, 131 (4<sup>th</sup> Cir. 1990) (italics added). Likewise, in *Kansas*, the Board stated that “[t]he exception for adjustments to prior year costs is intended to cover unforeseen and unavoidable adjustments to account for differences between a final rate determined using actual allowable costs incurred in providing the services and the interim rates estimated based on the hospitals’ reported costs from an earlier year trended forward.” *Kansas*, DAB No. 2014, at 2.

We see no material difference between *Kansas* and the facts of the present case. In both cases, a state sought to belatedly adjust its interim rates to account for categories of costs that it was aware of but chose not to include in the interim rate calculations and then made later adjustments that it could not show were consistent with its state plan procedures.

West Virginia acknowledges that “[t]he interim rates [for SBHS] took into account the salary and other direct costs reported through the [1999] paper survey *but did not include indirect and overhead costs*, which could not be precisely calculated until [its computer system] was fully implemented [which occurred in ‘late 2002’].” W. Va. Br. at 3 (citing Brennan Decl. ¶¶ 6, 11-12 (emphasis added)). It is clear on the record that West Virginia, like Kansas, knew of the existence of SBHS-related operating and indirect costs but chose not to include any claim for them in its interim rates. *See* Brennan Decl. ¶¶ 6, 11-12. The development of the automated cost reporting system (WVEIS) may have made possible more precise calculations of the amounts of operating costs but that does not provide a reason that estimated figures were not or could not have been included in interim rates to reflect the asserted intention to treat such costs as part of the SBHS rates. Moreover, West Virginia does not explain why, if PCG could obtain the published indirect cost rates for SFY 2001 in SFY 2003, West Virginia could not have obtained the school districts’ indirect cost rates for SFY 1999 (or an estimate of those rates) to use in the interim rate calculation.

West Virginia does not contend that it was unaware of SBHS-related operating and indirect costs when it calculated its interim rates, nor has it shown that claiming the

adjustment beyond the permitted two-year filing period was unavoidable despite reasonable diligence. Furthermore, according to Mr. Brennan, the WVEIS was operational in “late 2002.” Brennan Decl. ¶ 12. If so – and it is unclear what he means by “late” 2002 – the State could have made rate adjustments before December 31, 2002, a date less than two years after the first of the three quarters subject to the disallowance. Instead, the claimed adjustment was made beyond the two-year filing period suggesting that the delay was not based only on the lack of any earlier mechanism to gather accurate cost data. The Board has held that exceptions to the two-year filing rule “do not apply to the routine situation where a state simply did not get around to getting its data together in time to file a claim within the statutory requirements.” *Maryland*, DAB No. 1909, at 4 (internal quotation omitted). A state has an obligation to gather the data necessary for FFP in a timely manner, and West Virginia did not do so here.

Our past decisions, including *South Carolina* and *Pennsylvania*, indicate another key factor for the exception to apply is that a state must show that a subsequent adjustment to an interim rate is consistent with and contemplated by its state plan and methodology. *South Carolina*, DAB No. 943, at 7 (“The exception for adjustments to prior year costs is intended to give a state a reasonable opportunity to adjust its interim rate, consistent with the methods and procedures of its established rate-setting methodology”); *Pennsylvania*, DAB No. 703, at 3-4 (1985) (noting that a claim may be an adjustment to prior year costs where the adjustment was contemplated by the state’s rate-setting system and not prohibited by the state’s Medicaid plan). Here, the record indicates that the retrospective rate adjustment at issue was not contemplated by the rate-setting system in West Virginia’s state Medicaid plan. The language in the state plan itself is silent with regard to whether operating and indirect costs would be reimbursed or included in either the interim rate or final rate. More importantly, the relevant SPA refers to “cost settled on an annual basis,” but West Virginia did not show that the adjustment at issue was consistent with its cost settlement process.

Usually, the cost settlement process in a retrospective system involves the service provider filing a cost report after the end of the cost reporting period, a state agency review of the report, including an on-site audit of the provider’s records, if needed, and a determination of the final rate. *See, e.g.*, 42 C.F.R. §§ 413.64(f); 447.253(g); W. Va. Ex. 8 (describing West Virginia’s retrospective system for inpatient psychiatric facility services). The regulatory definition of an adjustment to prior year costs recognized that this cost settlement process, including possible audits and appeals, might unavoidably take more than the two-year period. West Virginia acknowledges that “cost settlement” is a term of art associated with Medicare cost principles. W. Va. Response to Questions at 2. Yet, West Virginia presented no evidence that shows it intended to adopt or did adopt any different cost settlement process than the normal one, either for the services at issue here or, in general, for all cost settlements under the state plan.

In fact, the record shows that the adjustments at issue here were not consistent with the concept of “cost settlement” as that term is usually understood. The adjustments resulted



from recommendations made by PCG. PCG was not hired to review reported costs to identify any errors or inconsistencies or to audit the records of the school districts to determine whether they correctly reported their actual costs. Instead, PCG was hired to “identify existing federal sources which the [State] is either underutilizing or not maximizing all available federal funds” and to assist the State in recovering additional funds. WV Ex. 11, at 2. PCG’s report shows that it “analyzed the procedures used to calculate the rate,” collected new cost information (including from sources other than the WVEIS), “adapted the previous rate methodology,” and “made other adjustments to the calculation process . . . .” CMS Ex. 5, at 3-5. PCG submitted a report to West Virginia proposing a methodology to “correct” the rates and procedures.<sup>4</sup> *Id.* at 6. Thus, the disallowed adjustments were not made for the purpose of reconciling estimated and actual costs – as would have been typical under a retrospective payment system. In other words, the rate adjustments here were not the inevitable result of having a retrospective payment system but instead were necessitated by West Virginia’s own inaction. As we said in similar circumstances in *Kansas*, “[t]he need for the adjustments was not an integral facet or a necessary result of having a retrospective reimbursement system that makes rate adjustments beyond the two-year period unforeseen and unavoidable.” *Kansas*, DAB No. 2014, at 2. Instead, West Virginia attempted to belatedly include in its SBHS rates entirely new categories of costs that the State was aware of earlier but simply chose not to include in its interim SBSH rates. *See New Jersey Dept. of Human Services*, DAB No. 1773, at 3-4, 6 (2001) (*citing* 46 Fed. Reg. 3527, 3528 (1981), the preamble to 45 C.F.R. § 95.7).

West Virginia argues that the Board’s decisions in *Kansas*, as well as *South Carolina*, “are inapplicable to the present case.” W. Va. Br. at 12. “Unlike in *Kansas*,” the State asserts, it “did not file retroactive claims for *new services*, nor did it reopen finalized cost settlements or intentionally exclude operating and indirect costs.” *Id.* at 14 (italics in original). According to West Virginia, the Board’s prior *Pennsylvania* decision “controls this case.” *Id.* at 10. Specifically, West Virginia contends that the *Pennsylvania* decision is indistinguishable from the present case because “the relevant ‘cost items’ in the present case were the previously claimed *services*, not the underlying costs used to calculate the interim or final rates.” *Id.* at 11-12 (italics added).

We disagree that *Pennsylvania* is controlling here. In *Kansas*, the Board characterized the *Pennsylvania* decision as holding that the State’s inadvertent failure to include the costs of rentals and general obligation bond charges when calculating its interim rates or final cost settlements (a lapse *Pennsylvania* attributed to a lack of communication between its State agencies) did not preclude its subsequently including those costs and

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<sup>4</sup> What PCG did contrasts with what West Virginia did in the representative sample of “cost settlement letters” submitted by West Virginia for a range of types of providers, which are directed to the providers, refer to “cost settlement,” identify the settlement as either “final” or “tentative,” and offer the provider an opportunity for a further review or an administrative hearing. WV Ex. 16.

claiming FFP under the exception for prior year adjustments. *See Kansas* at 14; *Pennsylvania*, DAB No. 703, at 3-4. However, in *Kansas* (and in *South Carolina* as well), the Board “expressly limited [its] holdings in [*Pennsylvania* and in *Ohio Dept. of Public Welfare*, DAB No. 622 (1986)] to the facts of those cases, that is, where the States *mistakenly omitted* certain cost items and then made adjustments permitted by their retrospective rate-setting systems.” *Kansas*, DAB No. 2014, at 14 (emphasis added); *South Carolina*, DAB No. 943, at 6. The Board further stated:

[T]he principle of these cases should not be extended any further than their particular facts. Where an interim per diem rate was claimed within two years, and then a state later realized that it had *mistakenly* not included costs of particular items in computing the final rate, the state can properly recompute its final rate to include the omitted costs only if the state’s retrospective rate-setting process permits it to re-open a final rate and the adjustment itself is one reasonably encompassed by the state’s retrospective system. Without this proviso, the rationale underlying the timely claiming requirements would be undercut so that any rate recalculation would be proper so long as a state had a retrospective system.

*Id.* at 6-7 (italics in original).

The record in this case does not support a finding that West Virginia mistakenly failed to include overhead and indirect costs in its interim rate calculations. Indeed, as already noted, it is clear from the record that West Virginia, like *Kansas*, knew these costs existed but chose not to include them in its interim rates. As previously discussed, West Virginia’s own evidence indicates that it was aware of the overhead and indirect costs and chose to omit them from calculating the interim rate for SBHS.

West Virginia also contends that *South Carolina* (upon which *Kansas* relies) does not apply to the present case because it “*always intended* to reimburse the total, actual costs of providing SBHS, but did not include operating and indirect costs in interim rate calculations due to a lack of reliable, historical cost data.” W. Va. Br. at 13 (italics added) (citing Brennan Decl. ¶¶ 6-7, 10-16); W. Va. Ex. 3 (Franco-Atkins Letter at 3). West Virginia further contends that these costs “were included in the cost settlements as soon as the information was available.” W. Va. Br. at 15. West Virginia also states that it “was cautious not to overestimate costs as it did not want to be in a position of having to recover funds from schools if the interim estimates were to exceed actual costs.” *Id.* at 3-4 (citing Brennan Decl. ¶ 9); W. Va. Ex. 3 (Franco-Atkins Letter at 3).

This argument is without merit. The Board rejected an analogous argument in *Kansas*, where the state claimed that its “auditors did not include the [education] costs in their preliminary and initial post-Medicare-audit settlements” but excluded the costs “with the *express intention* and understanding that education costs would be added when the required documentation is available.” *Kansas*, DAB No. 2014, at 15 (italics added,

internal quotation omitted). By stating it “always intended” to include the overhead and indirect costs at some future date, after development of a method for adequately documenting the costs, West Virginia, like Kansas, admits that it knowingly excluded the costs from its interim rate calculations. Mr. Brennan’s discussion about West Virginia’s reasons for excluding overhead and indirect costs when calculating the interim rate for SBHS only reinforces our conclusion that West Virginia did not “mistakenly” exclude those costs in calculating the interim rate for SBHS. *See* Brennan Decl. ¶¶ 6-7, 10-16.

Moreover, West Virginia submitted “final” SBHS rates to CMS in a February 2000 report entitled “Presentation to HCFA [-] Calculation of *Final Rates* for Special Education Medicaid-Reimbursable Services.” CMS Ex. 3 (emphasis added). As suggested by the title of the presentation, it is not reasonable to infer that West Virginia intended to subsequently adjust the interim rate to include overhead and indirect costs. In that presentation, West Virginia submitted salaries and fringe benefits as the *only* cost categories for its final rate for SBHS. This submission does not mention or otherwise indicate that West Virginia intended to subsequently include the relevant operating and indirect costs in its final rate for SBHS. In addition, West Virginia’s presentation did not put CMS on notice that the State anticipated it would need to subsequently adjust the interim rate to include operating and indirect costs or otherwise needed to obtain additional information regarding cost categories before it claimed FFP for SBHS.

We stress that the payment rate-setting process at issue here is one that the State controlled. Here, West Virginia could have developed procedures that permitted it to include operating and indirect costs that were not included in calculating the interim rate, but did not do so, even though it was aware those types of costs existed as part of providing SBHS. We do not intend to suggest that a state could never subsequently adjust an interim rate to include costs that were not used in its interim rate calculations. Instead, we conclude only that West Virginia has not shown here that it had established procedures consistent with its state plan to make adjustments to the interim SBHS rates of the type made here.

West Virginia further argues that, even if the *Pennsylvania* decision does not control the outcome of this case, the adjustment to subsequently include overhead and indirect costs was still appropriate because it consistently interpreted its state plan to require the reimbursement of the total, actual costs of providing SBHS. W. Va. Br. at 20-21. The record does not establish, however, that West Virginia always interpreted its state plan to mean that it was *required* to reimburse total, actual costs of providing SBHS. The language to which West Virginia points in SPA 00-01 does not *require* the reimbursement of the total, actual costs of providing SBHS. Instead, the language of the state plan for SBHS provides that West Virginia would be reimbursed for “costs not to exceed actual, reasonable costs.” CMS Ex. 5.

West Virginia further argues that operating and indirect costs are normally included in determining what constitutes “actual, reasonable costs.” West Virginia attempts to

buttress its interpretation by maintaining that it has consistently used Medicare principles of cost reimbursement as reflected in 42 C.F.R. § 413.9 to calculate costs for other cost-based programs. *See* Brennan Decl. ¶ 11; W. Va. Response to Questions at 2. However, West Virginia’s argument focuses on the concept of allowability of operating and indirect costs under Medicare reimbursement principles rather than addressing the limited purpose of the exception for the two-year filing requirement.<sup>5</sup> *See* W. Va. Response at 2. In addition, West Virginia has failed to provide any documentation contemporaneous with SPA 00-01 that it intended to reimburse overhead and indirect costs related to the “actual, reasonable cost” of providing SBHS. In response to a series of questions from the Board to the parties, West Virginia acknowledged that it “has reviewed its files and does not have any documents which describe or memorialize the discussions [with CMS regarding the meaning of the term “actual, reasonable costs” contained in SPA 00-01].” *Id.* In its response, West Virginia also submitted its state Medicaid plan for some of these programs (*e.g.*, in-patient psychiatric services for individuals under 22 years of age, FQHCs, medical and remedial care and services, and LTC facilities), which consistently provide that payment is to be determined by current Medicare or Medicaid principles of methodology of cost-based reimbursement. *Id.* at Attachments 8-10; *see also* CMS Ex. 4. As previously discussed, however, the language in West Virginia’s state Medicaid plan for SBHS is different from that used in its Medicaid plans for calculating the costs of these other services and does not *require* the reimbursement of the total, actual costs of providing SBHS. Instead, the language of the state plan for SBHS provides that West Virginia would be reimbursed for “costs not to exceed actual, reasonable costs.” CMS Ex. 4 at 5-6. Thus, not including operating and indirect costs in the final rate would not have caused West Virginia to be in violation of its state plan as it claims. W.Va. Br. at 21.

The issue before us is not whether operating and indirect costs are allowable under SPA 00-001 as “actual reasonable, costs” but whether, having chosen to omit them from its initial rate development process, West Virginia may wait until after the timely claims deadline passes and then seek to add them retrospectively to its rates as an adjustment to prior year costs. In that context, the adjustment at issue here is also inconsistent with the purpose of the two-year time-limit to file claims for FFP. “The main purpose of this time limit is to ensure that states finalize their Medicaid reimbursement requests in a timely fashion.” *South Carolina*, 915 F.2d 129, 1321 (4<sup>th</sup> Cir. 1990), *citing New York*, DAB No. 521, at 8 (1984). As we stated in *New York*, Congress’s intent in legislating the two-year limitation in section 1132(a) of the Act was “to prevent the states from coming in many years after expenditures were made and claiming FFP . . . Such delayed claiming made it difficult for the Department of Health and Human Services to plan its budget.” DAB No.

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<sup>5</sup> Indeed, the SPA language of “not to exceed actual, reasonable costs” suggests that the State intended to reimburse at a rate less than actual cost, which would indicate that it did not necessarily intend to include overhead/indirect costs and which is consistent with an intention to limit reimbursement to salaries and fringe benefits.

521, at 8, *citing Connecticut*, 684 F.2d at 982. To that end, the Board has held that the statutory exceptions to the two-year limit “were intended to cover only extreme situations . . . where it would be patently unfair to a state to outlaw its claim merely because of the passage of time.” DAB No. 521, at 8. That is not the situation here because West Virginia was in control of the process to gather data and estimate its interim rates for SBHS in a timely manner, as well as establishing the necessary procedures and methodology in its state plan to subsequently adjust those rates to add operating and indirect costs.

### **Conclusion**

For the reasons discussed, we sustain CMS’s January 22, 2010 determination to disallow \$2,298,329 in FFP that the state of West Virginia claimed as Medicaid expenditures for school-based health services.

/s/

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Judith A. Ballard

/s/

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Leslie A. Sussan

/s/

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Stephen M. Godek  
Presiding Board Member