

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**ARIZONA IMPROPERLY CLAIMED  
FEDERAL REIMBURSEMENT FOR  
MEDICAID SCHOOL-BASED  
ADMINISTRATIVE COSTS**

*Inquiries about this report may be addressed to the Office of Public Affairs at  
[Public.Affairs@oig.hhs.gov](mailto:Public.Affairs@oig.hhs.gov).*



**Daniel R. Levinson  
Inspector General**

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# *Office of Inspector General*

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## EXECUTIVE SUMMARY

### BACKGROUND

#### Medicaid Coverage of School-Based Administrative Costs

Congress amended section 1903(c) of the Social Security Act (the Act) in 1988 to allow Medicaid coverage of health-related services provided to children under the Individuals with Disabilities Education Act. The school-based health program permits children to receive health-related services, generally without having to leave school. The Act provides for States to be reimbursed for administrative activities that directly support identifying and enrolling potentially eligible children in Medicaid. The Federal reimbursement is 50 percent of allowable administrative expenses.

School or school district employees may perform multiple administrative activities related to Medicaid and other programs not eligible for Federal Medicaid reimbursement. According to Federal regulations, one acceptable method for allocating employees' salaries and wages to Medicaid is random moment sampling, which uses random moment timestudies (RMTS). The sampling methodology must meet acceptable statistical sampling standards, including that the results must be statistically valid.

The Centers for Medicare & Medicaid Services' (CMS) *Medicaid School-Based Administrative Claiming Guide* (CMS guide), dated May 2003, provides information on the appropriate methods for claiming Federal reimbursement for costs of Medicaid administrative activities performed in the school setting. It requires that documentation be retained to support timestudies used to allocate costs, including the sample universe determination, sample selection, and sample results.

#### Arizona's Medicaid School-Based Administrative Claiming Program

In Arizona, the Arizona Health Care Cost Containment System Administration (State agency) administers the Medicaid program. The State agency contracted with MAXIMUS, Inc. (Maximus), to manage the Medicaid Administrative Claiming (MAC) program. The MAC program allows local education agencies to receive Federal reimbursement through the State agency for costs of Medicaid administrative activities in the school setting. The State agency developed its own MAC guides (State guide) in calendar years 2004 (amended in October 2008), 2009, and 2010. CMS approved the 2010 guide on June 7, 2010.

The 2004 State guide (applicable to our audit period) required Maximus to conduct an RMTS to determine the total costs and the Federal reimbursement for Medicaid school-based administrative activities for each quarter. Maximus (1) randomly selected moments in time (random moments) from a universe of total available moments and matched them with randomly selected names from a universe of RMTS participants; (2) distributed an observation form for each selected participant, who completed the form with a brief description of the activity performed at the random moment; (3) used the information recorded on the observation forms to calculate a statewide percentage of time spent on Medicaid administrative activities (statewide Medicaid percentage); and (4) applied this percentage to the selected costs of local education

agencies to determine the total costs and the Federal reimbursement. In this report, we refer to this process as “the RMTS methodology.”

CMS requested that we review Medicaid school-based administrative costs that the State agency claimed. Specifically, we reviewed \$61,091,772 (\$30,545,822 Federal share) for Medicaid school-based administrative costs claimed on behalf of approximately 200 local education agencies that participated in the MAC program during the period January 1, 2004, through September 30, 2008 (a total of 19 quarters).

## **OBJECTIVES**

Our objectives were to determine whether (1) the State agency maintained required documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program and (2) the RMTS methodology was consistent with Federal requirements.

## **SUMMARY OF FINDINGS**

The State agency did not always maintain required documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program, and the RMTS methodology was not fully consistent with Federal requirements. Of the \$30,545,822 (Federal share) claimed, we determined that \$11,716,850 was unallowable, and we set aside the remaining \$18,828,972 for CMS resolution.

For 2 of the 19 quarters, the State agency did not maintain required documentation to support (1) the universes of total available moments in time and RMTS participants and/or (2) the sample of random moments for selected participants. Because the State agency did not maintain this documentation, the \$5,421,711 in Federal reimbursement that it received for these quarters was unallowable.

For the remaining 17 quarters, the State agency’s RMTS methodology was not fully consistent with Federal requirements:

- The State agency inappropriately discarded sample items when calculating the statewide Medicaid percentages. We determined that \$6,295,139 of Federal reimbursement was unallowable on the basis of the revised statewide Medicaid percentages we calculated.
- The RMTS methodology did not meet acceptable statistical sampling standards because the universes from which the sample items were selected were incomplete or incorrect. Because we were unable to determine which portion of the State agency’s claim for Federal reimbursement would have been allowable if complete or correct universes had been used to calculate the statewide Medicaid percentages, we set aside the remaining \$18,828,972 for CMS resolution.

The State agency did not have adequate controls to ensure that it maintained all required documentation to support the RMTS methodology and that the RMTS methodology was

consistent with Federal requirements. In addition, the 2004 State guide included incorrect guidance that allowed Maximus to discard sample items.

## **RECOMMENDATIONS**

We recommend that the State agency:

- refund to the Federal Government \$11,716,850 for unallowable school-based administrative costs,
- work with CMS to determine the allowability of \$18,828,972 that we set aside and refund to the Federal Government any amount determined to be unallowable,
- strengthen controls to ensure that all required documentation to support the RMTS methodology is maintained and the RMTS methodology is consistent with Federal requirements, and
- review periods after our audit period and make appropriate financial adjustments for any unallowable school-based administrative costs claimed.

## **STATE AGENCY COMMENTS**

In written comments on our draft report, the State agency concurred with our third and fourth recommendations. However, the State agency did not concur with our recommendation to refund \$11,716,850. The State agency commented that it objected to any findings based on incomplete documentation for any dates before July 1, 2007, because it was under no obligation to maintain those records beyond the 3-year retention period required by Federal regulations. In addition, the State agency commented that because CMS was aware of the State agency's proposed RMTS methodology, our decision to recommend a disallowance associated with discarded sample items was in error. Finally, the State agency did not concur with our findings resulting in the recommended set-aside amount and commented that it explicitly reserved the right to contest the findings in any action taken by CMS. The State agency's comments are included in their entirety as Appendix D.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

We disagree that the State agency was under no obligation to maintain records beyond the 3-year retention period. As established by Federal cost principles and State law, the record retention period is 5 years from the date of final payment. Because the State agency received notice of our ongoing audit in a letter dated October 20, 2008, it should have retained all records relevant to school-based administrative costs for the entire audit period. Further, because CMS did not approve the State agency's proposed RMTS methodology, the State agency should have followed the CMS guide. Also, the State agency did not provide any information explaining its nonconcurrence with our findings that resulted in a set-aside amount. We maintain that our findings and recommendations are valid.

# TABLE OF CONTENTS

	<u>Page</u>
<b>INTRODUCTION</b> .....	1
<b>BACKGROUND</b> .....	1
Medicaid Program.....	1
Medicaid Coverage of School-Based Administrative Costs.....	1
Random Moment Sampling and Timestudies.....	2
Arizona Health Care Cost Containment System Administration and Third-Party Administrator.....	2
Administration of Arizona’s Medicaid Administrative Claiming Program .....	2
State Agency’s Random Moment Timestudy Methodology .....	3
<b>OBJECTIVES, SCOPE, AND METHODOLOGY</b> .....	4
Objectives .....	4
Scope.....	4
Methodology.....	5
<b>FINDINGS AND RECOMMENDATIONS</b> .....	6
<b>INADEQUATE DOCUMENTATION TO SUPPORT     SAMPLING METHODOLOGY</b> .....	7
Federal and State Requirements.....	7
No Documentation for Sample Universe Determination and/or Sample Selection .....	7
<b>SAMPLING METHODOLOGY NOT FULLY CONSISTENT WITH     FEDERAL REQUIREMENTS</b> .....	8
Inappropriately Discarded Sample Items.....	8
Incomplete or Incorrect Sample Universes.....	10
<b>LACK OF ADEQUATE CONTROLS</b> .....	11
<b>RECOMMENDATIONS</b> .....	12
<b>STATE AGENCY COMMENTS</b> .....	12
<b>OFFICE OF INSPECTOR GENERAL RESPONSE</b> .....	13
<b>APPENDIXES</b>	
<b>A: SUMMARY OF DEFICIENCIES BY QUARTER</b>	

B: UNALLOWABLE AND SET-ASIDE FEDERAL REIMBURSEMENT  
BY QUARTER

C: ORIGINAL AND REVISED STATEWIDE MEDICAID PERCENTAGES  
BY QUARTER

D: STATE AGENCY COMMENTS

## INTRODUCTION

### BACKGROUND

#### Medicaid Program

Pursuant to Title XIX of the Social Security Act (the Act), the Medicaid program provides medical assistance to certain low-income individuals and individuals with disabilities. The Federal and State Governments jointly fund and administer the Medicaid program. At the Federal level, the Centers for Medicare & Medicaid Services (CMS) administers the program. Each State administers its Medicaid program in accordance with a CMS-approved State plan. Although the State has considerable flexibility in designing and operating its Medicaid program, it must comply with applicable Federal requirements.

Section 1903(a)(7) of the Act permits States to claim Federal reimbursement for 50 percent of the costs of Medicaid administrative activities that are necessary for the proper and efficient administration of the State plan. States claim Federal reimbursement for eligible Medicaid expenditures on the Form CMS-64, Quarterly Medicaid Statement of Expenditures for the Medical Assistance Program.

Federal regulations (2 CFR part 225, *Cost Principles for State, Local, and Indian Tribal Governments*) contain principles and standards for determining allowable costs incurred by State governments under Federal awards. Appendix A, section C.1., states that costs must be reasonable, necessary, and allocable to Federal awards.

#### Medicaid Coverage of School-Based Administrative Costs

Congress amended section 1903(c) of the Act in 1988 to allow Medicaid coverage of health-related services provided to children under the Individuals with Disabilities Education Act. The school-based health program permits children to receive health-related services, generally without having to leave school. The Act allows States to be reimbursed for administrative activities that directly support medical assistance services, including identifying and enrolling potentially eligible children in Medicaid. Administrative functions may include outreach, eligibility intake, information and referral, health service coordination and monitoring, and interagency coordination. The Federal reimbursement is 50 percent of allowable administrative expenses. Because both Medicaid-eligible and non-Medicaid-eligible students receive health-related services, the administrative costs of supporting these services must be allocated between the two groups.

In May 2003, CMS issued a guide entitled *Medicaid School-Based Administrative Claiming Guide* (CMS guide) on how schools and State Medicaid agencies should claim Federal reimbursement for costs of Medicaid administrative activities performed in the school setting. The CMS guide clarifies and consolidates CMS's guidance on how to meet statutory and regulatory requirements and explains the application of such requirements. This explanation covers how to properly allocate school-based administrative costs to ensure that States claim only administrative costs that are eligible for Federal reimbursement under the Medicaid program.

## **Random Moment Sampling and Timestudies**

School or school district employees may perform multiple administrative activities related to Medicaid and other programs not eligible for Federal Medicaid reimbursement. State Medicaid agencies may use either of two methods to allocate employees' salaries and wages to Medicaid: (1) personnel activity reports (e.g., timesheets) that reflect an after-the-fact distribution of the actual activity of each employee or (2) a substitute system, such as random moment sampling.

According to 2 CFR part 225, random moment sampling, which uses random moment timestudies (RMTS), is one of the federally acceptable methods for allocating costs to Federal awards when employees work on multiple activities not allocable to a single Federal award. The CMS guide clarifies the random moment sampling requirements in 2 CFR part 225 by providing information on the sample universe,<sup>1</sup> sampling plan methodology, treatment of the summer period, RMTS documentation, training for RMTS participants, and monitoring process.

## **Arizona Health Care Cost Containment System Administration and Third-Party Administrator**

In Arizona, the Arizona Health Care Cost Containment System Administration (State agency) administers the Medicaid program. Effective January 2004, the State agency entered into a contingency fee contract with MAXIMUS, Inc. (Maximus), to manage the Medicaid Administrative Claiming (MAC) program as a third-party administrator. The MAC program allows local education agencies to receive Federal reimbursement through the State agency for costs of Medicaid administrative activities in the school setting.<sup>2</sup>

The contract stated that Maximus was required to comply with the procedures in the CMS guide when claiming school-based administrative costs and to retain "all necessary financial and programmatic records, supporting documentation, statistical records and other related documents ...." The contract also stated that the State agency would perform oversight activities, including but not limited to policy development, claims processing, and auditing.

## **Administration of Arizona's Medicaid Administrative Claiming Program**

To administer the MAC program, the State agency developed its own MAC guides (State guide) in calendar years 2004 (amended in October 2008), 2009, and 2010 and submitted them to CMS for approval. CMS approved only the 2010 State guide on June 7, 2010.<sup>3</sup> The purpose of the

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<sup>1</sup> The universe is also called the population.

<sup>2</sup> In Arizona, local education agencies include public school districts, charter schools not sponsored by a school district, and the Arizona State Schools for the Deaf and the Blind. Local education agencies must enter into an agreement with the State agency to participate in the MAC program.

<sup>3</sup> Federal cost principles (2 CFR part 225, Appendix B, section 8.h.(6)) and section V.B. of the CMS guide indicate that a State's use of a substitute system, including the alternate methodology for allocating salaries and wages described later in this report in the subsection entitled "Inappropriately Discarded Sample Items," is subject to CMS approval. However, CMS did not approve or disapprove the State guides developed in calendar years 2004 (amended in 2008) and 2009.

State guide was to inform Maximus and local education agencies on how to claim quarterly the Federal reimbursement for costs of Medicaid school-based administrative activities.

The quarterly MAC program claiming process included the following steps: (1) local education agencies reported RMTS participants and costs<sup>4</sup> to Maximus, (2) Maximus conducted the statewide RMTS, (3) Maximus used the RMTS results to allocate the costs of Medicaid school-based administrative activities and prepared an invoice<sup>5</sup> for each local education agency, (4) Maximus compiled all invoices into a summary sheet after local education agencies verified the accuracy of the invoices, (5) Maximus submitted the summary sheet to the State agency, and (6) the State agency reported on the Form CMS-64 the total costs and the Federal reimbursement amount shown on the summary sheet.

### **State Agency's Random Moment Timestudy Methodology**

The State agency used RMTS to identify, measure, and allocate the local education agency employees' time that was devoted to Medicaid school-based administrative activities and calculated the total costs and the Federal reimbursement for the MAC program. The 2004 State guide required Maximus to conduct an RMTS on behalf of the State agency for each quarter.

Maximus created two sample universes: a universe of total available moments in time and a universe of all RMTS participants. Maximus used a computer software program to randomly select a moment in time (described as a specific 1-minute unit of a specific day) from a universe of total available moments and matched it with a randomly selected name from a universe of RMTS participants. A sample item was a random moment for a randomly selected RMTS participant.

Maximus generated an observation form for each sample item, and each selected RMTS participant was informed of his or her random moment in advance.<sup>6</sup> The selected participant was required to complete the observation form for the random moment by (1) choosing the activity code that best described the activity performed at the random moment,<sup>7</sup> (2) providing a written

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<sup>4</sup> The local education agencies submitted participant lists before the start of the applicable quarter and the costs after the end of the applicable quarter. Participants were local education agencies' employees who were expected to spend time on Medicaid administrative activities. Costs included salaries and wages and fringe benefits of all RMTS participants, staff providing support exclusively to those RMTS participants, and selected direct and indirect costs of local education agencies.

<sup>5</sup> The invoice included data on direct and indirect costs, the Medicaid eligibility rate, and the RMTS results. The formulas imbedded in the invoice calculated the total claimable amount and the Federal reimbursement for each local education agency.

<sup>6</sup> Before the fourth quarter of 2006, Maximus generated hardcopies of observation forms and sent them to local education agencies for distribution to selected RMTS participants. Beginning in the third quarter of 2006, Maximus used a Web-based program that enabled selected participants to complete observation forms online. Maximus still sent hardcopy observation forms to some local education agencies.

<sup>7</sup> As of the third quarter of 2005, the selected RMTS participants were not required to identify the activity code. Maximus assigned the activity code on the basis of descriptions of activities provided by the selected participants.

description of the activity, (3) marking the appropriate position code checkbox, and (4) signing and dating the form. Maximus required participants to receive training on proper completion of observation forms.

Maximus used the information recorded on the observation forms to calculate a statewide percentage of time spent on Medicaid administrative activities (statewide Medicaid percentage). When participants did not return observation forms (i.e., nonresponses) or the forms had missing or inaccurate information, Maximus discarded from the calculation the sample items associated with those forms.<sup>8</sup> Maximus applied the statewide Medicaid percentage to the selected costs of local education agencies and determined the total costs and the Federal reimbursement.

In this report, we refer to the State agency's process for conducting the RMTS as "the RMTS methodology."

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

### **Objectives**

Our objectives were to determine whether (1) the State agency maintained required documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program and (2) the RMTS methodology was consistent with Federal requirements.

### **Scope**

CMS requested that we review Medicaid school-based administrative costs that the State agency claimed. Specifically, we reviewed \$61,091,772 (\$30,545,822 Federal share) for Medicaid school-based administrative costs that the State agency claimed on behalf of approximately 200 local education agencies that participated in the MAC program during the period January 1, 2004, through September 30, 2008 (a total of 19 quarters).

Our objectives did not require an understanding or assessment of the State agency's overall internal control structure. We limited our review to obtaining an understanding of the RMTS methodology that the State agency used to allocate Medicaid school-based administrative costs. We did not review (1) the allowability of the costs reported by local education agencies, (2) the services associated with those costs to determine whether they were allowable for reimbursement under Medicaid, or (3) the computer software that Maximus used to select sample items.

We conducted fieldwork at the State agency office in Phoenix, Arizona, and at selected local education agencies in Arizona.

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<sup>8</sup> When calculating the statewide Medicaid percentage, the State agency did not include nonresponses or observation forms with missing or inaccurate information. Removing (i.e., discarding) sample items reduces the sample size and may result in a higher statewide Medicaid percentage and more Federal reimbursement.

## Methodology

To accomplish our objectives, we:

- reviewed applicable Federal laws, regulations, and guidance and the State plan;
- reviewed the contract between the State agency and Maximus for the MAC program;
- reviewed the State guides developed in calendar years 2004 (amended in October 2008), 2009, and 2010;
- interviewed CMS officials to obtain an understanding of the RMTS methodology and documentation requirements in the CMS guide;
- interviewed officials from the State agency, Maximus, and selected local education agencies to obtain an understanding of the MAC program and the State agency’s RMTS methodology for allocating school-based administrative costs to Medicaid;
- obtained from the State agency computer-generated data files<sup>9</sup> related to Medicaid school-based administrative costs claimed for the audit period;
- verified the mathematical accuracy of the State agency’s calculations of Medicaid school-based administrative costs reported on the invoices and summary sheets for the MAC program;
- determined whether the State agency’s RMTS results were statistically valid by obtaining a professional opinion from our statistical consultant, who evaluated
  - our description of the findings as presented in the section entitled “Sampling Methodology Not Fully Consistent With Federal Requirements,”
  - the result of our analysis showing the sample size and the number of discarded sample items for each quarter (when available), and
  - CMS’s responses to our questions related to the discarded sample items;
- reviewed the quarterly data files and observation forms to determine the number of sample items that Maximus selected but discarded when calculating a statewide Medicaid percentage and to identify activity codes for the discarded sample items;<sup>10</sup>
- recalculated the statewide Medicaid percentages on the basis of our review of the quarterly data files and observation forms;

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<sup>9</sup> The data files included the sample universe, sample selection, sample results, invoices, and summary sheets for each quarter, when available.

<sup>10</sup> We did not determine whether the activity codes on the observation forms were correct.

- used the State agency’s formulas for calculating Medicaid school-based administrative costs and determined the effect on the Federal reimbursement by comparing the original claiming invoices with the revised invoices; and
- shared the results of our review with CMS and State agency officials.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### **FINDINGS AND RECOMMENDATIONS**

The State agency did not always maintain required documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program, and the RMTS methodology was not fully consistent with Federal requirements. Of the \$30,545,822 (Federal share) claimed, we determined that \$11,716,850 was unallowable, and we set aside the remaining \$18,828,972 for CMS resolution.

For 2 of the 19 quarters, the State agency did not maintain required documentation to support (1) the universes of total available moments in time and RMTS participants and/or (2) the sample of random moments for selected participants. Because the State agency did not maintain this documentation, the \$5,421,711 in Federal reimbursement that it received for these quarters was unallowable.

For the remaining 17 quarters, the State agency’s RMTS methodology was not fully consistent with Federal requirements:

- The State agency inappropriately discarded sample items when calculating the statewide Medicaid percentages. We determined that \$6,295,139 of Federal reimbursement was unallowable on the basis of the revised statewide Medicaid percentages we calculated.
- The RMTS methodology did not meet acceptable statistical sampling standards because the universes from which the sample items were selected were incomplete or incorrect. Because we were unable to determine which portion of the State agency’s claim for Federal reimbursement would have been allowable if complete or correct universes had been used to calculate the statewide Medicaid percentages, we set aside the remaining \$18,828,972 for CMS resolution.

See Appendix A for a summary of deficiencies for each quarter and Appendix B for our calculation of the unallowable and set-aside Federal reimbursement for each quarter.

The State agency did not have adequate controls to ensure that it maintained all required documentation to support the RMTS methodology and that the RMTS methodology was

consistent with Federal requirements. In addition, the 2004 State guide included incorrect guidance that allowed Maximus to discard sample items.

## **INADEQUATE DOCUMENTATION TO SUPPORT SAMPLING METHODOLOGY**

The State agency did not always maintain required documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program.

### **Federal and State Requirements**

Federal regulations (42 CFR § 431.17(b)) state: “A State plan must provide that the Medicaid agency will maintain or supervise the maintenance of the records necessary for the proper and efficient operation of the plan. The records must include — Statistical, fiscal, and other records necessary for reporting and accountability as required by the Secretary.” Further, Federal regulations (42 CFR § 433.32) state: “A State plan must provide that the Medicaid agency and, where applicable, local agencies administering the plan will — Maintain an accounting system and supporting fiscal records to assure that claims for Federal funds are in accord with applicable Federal requirements.”

CMS’s *State Medicaid Manual*, Pub. No. 45, section 2497.3, requires the State agency to have a recordkeeping system that ensures that documentation supporting a claim is regularly maintained, easily retrieved, and readily reviewable.

The CMS guide, section V.B.4., states: “As with all administrative costs that are related to [RMTS], there must be documentation of the costs for which [Federal reimbursement] will be claimed under Medicaid. Documentation to be retained must support and include the following: the sample universe determination, sample selection, sample results, sampling forms, cost data for each school district, and summary sheets showing how each school district’s claim was compiled.”

The Arizona State plan, No. 95-15, section 4.7, says: “The [State] agency maintains or supervises the maintenance of records necessary for the proper and efficient operation of the plan, including records regarding ... administrative costs, and statistical ... records necessary for reporting and accountability, and retains these records in accordance with Federal requirements.”

### **No Documentation for Sample Universe Determination and/or Sample Selection**

For 2 of the 19 quarters, the State agency did not maintain required documentation to support the sample universe determination (i.e., universes of total available moments in time and all RMTS participants) and/or the sample selection (i.e., random moments for selected participants). Because the State agency did not maintain this documentation, the \$5,421,711 in Federal reimbursement that it received for these quarters was unallowable.

For the first quarter of 2004, the State agency provided us with copies of 3,559 filled-out observation forms (i.e., the sample results) but did not provide data files to support the sample universe determination and the sample selection. For the second quarter of 2005, the State

agency provided us with copies of 3,730 filled-out observation forms but did not provide a data file to support the sample universe determination. A Maximus official stated that Maximus could not locate the data files supporting the sample universe determination and the sample selection. Without these files, we could not determine whether the observation forms that the State agency provided were for the sample items selected for those two quarters. Because the State agency was unable to provide required documentation of the sample universe determination and/or sample selection, the Federal reimbursement for school-based administrative costs for those quarters was unallowable.

## **SAMPLING METHODOLOGY NOT FULLY CONSISTENT WITH FEDERAL REQUIREMENTS**

The RMTS methodology that the State agency used to allocate school-based administrative costs to the Medicaid program for 17 of the 19 quarters<sup>11</sup> was not fully consistent with Federal requirements in the following ways:

- The State agency inappropriately discarded sample items when calculating the statewide Medicaid percentage for each quarter.
- The RMTS methodology did not meet acceptable statistical sampling standards because the sample universes from which the State agency selected the sample items were incomplete or incorrect.

### **Inappropriately Discarded Sample Items**

#### *Federal Requirements*

The CMS guide, section V.A., states: “The burden of proof ... of time study sample results remains the responsibility of the states.” Further, section V.B.2. of the guide states that the validity and reliability of the sampling methodology must be acceptable to CMS, and all nonresponses should be coded as non-Medicaid activities. CMS central office and regional officials informed us that section V.B.2. of the guide means that State Medicaid agencies may use alternate methodologies, including oversampling, to factor nonresponses into their methodology but only with prior approval from CMS. That is, any alternate methodology used to compensate for nonresponses must be submitted to CMS for review and approval before implementation and must also be statistically valid and reliable. CMS officials also informed us that observation forms with missing or inaccurate information are considered to be nonresponses and should be coded as non-Medicaid activities.

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<sup>11</sup> We did not evaluate the sampling methodology for 2 of the 19 quarters: the first quarter of 2004 and the second quarter of 2005. We disallowed the costs claimed for these quarters because the State agency did not maintain the required documentation. (See the discussion in the previous section.)

*Sample Items Inappropriately Discarded When  
Statewide Medicaid Percentages Were Calculated*

The State agency did not fully adhere to the provisions of the CMS guide regarding the treatment of nonresponses. Of 34,400 sample items related to observation forms sent to the statewide RMTS participants for the 17 quarters, the State agency inappropriately discarded 6,754 items when calculating the statewide Medicaid percentages. Of the 6,754 discarded items, 3,192 were for nonresponses (observation forms that were not returned), and 3,562 were for observation forms that had missing or inaccurate information, including no activity codes or description, no signature or date, and completion by someone other than the selected participant.

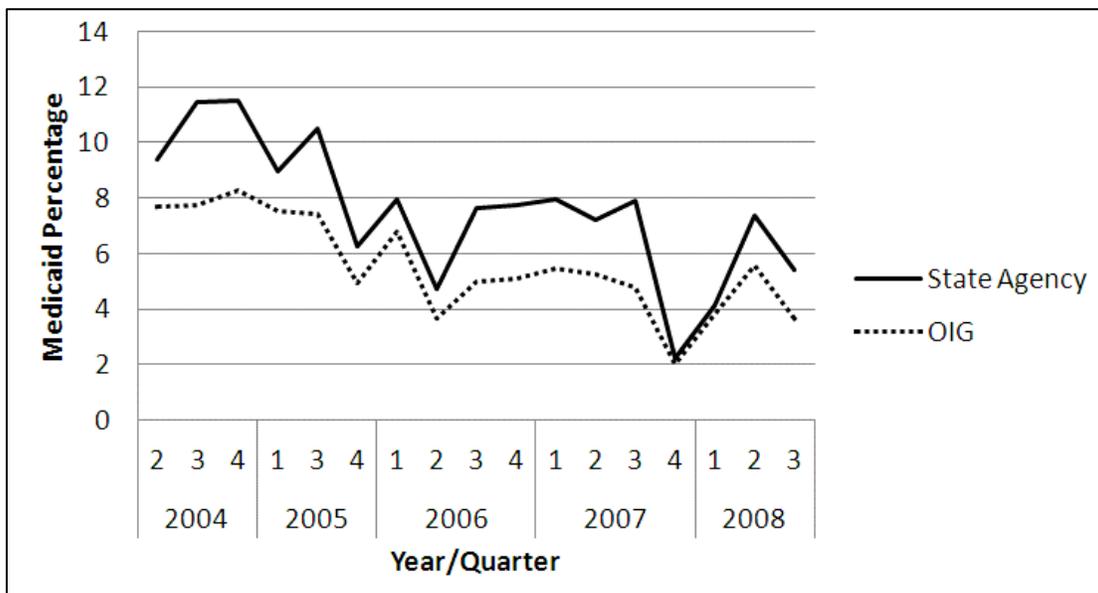
The State agency should have retained the discarded items in the sample and coded them as non-Medicaid activities, as stated in the CMS guide, because the State agency could not provide documentation that the discarded items were for Medicaid school-based administrative activities. By discarding the items, the State agency reduced the sample size, which resulted in higher statewide Medicaid percentages. The higher Medicaid statewide percentages led to increased Federal reimbursement.

We recalculated the statewide Medicaid percentage for each of the 17 quarters by including the discarded items in the sample and treating them as non-Medicaid activities unless the observation forms indicated otherwise. For those forms that the State agency discarded, we treated the items as Medicaid activities if the forms indicated that the activities were related to Medicaid.

Of the \$25,124,111 in Federal reimbursement that the State agency received for the 17 quarters, \$6,295,139 was unallowable on the basis of our revised statewide Medicaid percentages. To calculate the unallowable reimbursement for each quarter, we used the original invoice files provided by the State agency and entered our revised statewide Medicaid percentage. The invoices had embedded formulas to calculate the revised Federal reimbursement. The difference between the Federal reimbursements claimed on the original invoices and recalculated amounts on the revised invoices was unallowable. We totaled the differences for each quarter and local education agency and determined that \$6,295,139 was unallowable.

The graph on the next page illustrates the differences between the State agency's Medicaid percentages and our revised statewide Medicaid percentages for the 17 quarters. The graph does not show data for 2 of the 19 quarters—the first quarter of 2004 and the second quarter of 2005—because we could not calculate the revised statewide Medicaid percentages. (See the discussion in the previous section.)

**State Agency's Original and  
Office of Inspector General's (OIG) Revised  
Medicaid Percentages by Quarter**



See Appendix C for the statewide Medicaid percentages that the State agency used to determine the total costs and the Federal reimbursement and our revised statewide Medicaid percentages.

**Incomplete or Incorrect Sample Universes**

*Federal Requirements*

Federal cost principles (2 CFR part 225, Appendix B, section 8.h.(6)), state: “Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports .... Such systems may include ... random moment sampling.” Sections 8.h.(6)(a)(i), (ii), and (iii) state that sampling methods used to allocate salaries to Federal awards must meet acceptable statistical sampling standards, including (1) the sampling universe must include all of the employees whose salaries and wages are to be allocated on the basis of the sample results, (2) the entire time period involved must be covered by the sample, and (3) the results must be statistically valid and be applied to the period being sampled.

*Sample Items Selected From Incomplete or Incorrect Sample Universes*

The RMTS methodology did not meet acceptable statistical sampling standards because the sample universes from which the State agency selected the sample items were incomplete or incorrect:

- The sample universe for each quarter did not include all of the employees whose salaries and wages were allocated on the basis of the sample results. For 17 quarters, the universe

included certain employees but did not include their salaries and wages for allocation. For seven quarters, the sample universe did not include certain employees but included their salaries and wages for allocation.

- The sample universe did not cover the entire time period, i.e., employee work hours. For nine quarters, Maximus used a standardized work schedule when selecting random moments for the sample. The use of a standardized work schedule did not account for employees who had different work schedules. For example, during the quarter ended September 30, 2005, some employees were required to be at work by 7:15 a.m. Because the standardized work schedule for this quarter began at 8:00 a.m., 1-minute increments of those employees' work hours from 7:15 a.m. to 7:59 a.m. were not included in the universe and did not have a chance to be selected in the sample.
- Each sample item in the universe did not have an equal chance of being selected in the sample. For 12 quarters, the universe included some employees more than once. If an employee is included more than once in the universe, the number of random moments for that employee will be greater and will have a greater chance of being selected than the random moments for other employees. Therefore, for the 12 quarters, not all of the employees' random moments had an equal chance of being selected.

The State agency's RMTS methodology yielded statistically invalid sample results. For the sample results to be statistically valid, the universe must include all of the RMTS participants' salaries and wages for cost allocation, the universe must cover the entire time period of each employee's work hours, and each item in the universe must have an equal chance of being selected.

Because we were unable to determine which portion of the State agency's claim for Federal reimbursement would have been allowable if complete or correct universes had been used to calculate the statewide Medicaid percentages, we set aside \$18,828,972 for CMS resolution.

## **LACK OF ADEQUATE CONTROLS**

The State agency did not have adequate controls to ensure that it maintained all required documentation to support the RMTS methodology and that the RMTS methodology was consistent with Federal requirements. In addition, the 2004 State guide included incorrect guidance that allowed Maximus to discard sample items.

The State agency did not maintain adequate documentation to support the RMTS methodology used to allocate school-based administrative costs to the Medicaid program. The contract between the State agency and Maximus required Maximus to maintain all required documentation. The contract also provided that the State agency would oversee the MAC program. However, the State agency failed to exercise its oversight authority to ensure that Maximus maintained all required documentation to support the RMTS methodology. The State agency relied on Maximus to maintain all required documentation, including the documentation for the sample universe determination and the sample selection.

The State agency's 2004 State guide did not adhere to the CMS guide and stated that the State agency could discard sample items, such as nonresponses and observation forms with missing or inaccurate information, from the sample when calculating the statewide Medicaid percentage.<sup>12</sup>

## **RECOMMENDATIONS**

We recommend that the State agency:

- refund to the Federal Government \$11,716,850 for unallowable school-based administrative costs,
- work with CMS to determine the allowability of \$18,828,972 that we set aside and refund to the Federal Government any amount determined to be unallowable,
- strengthen controls to ensure that all required documentation to support the RMTS methodology is maintained and the RMTS methodology is consistent with Federal requirements, and
- review periods after our audit period and make appropriate financial adjustments for any unallowable school-based administrative costs claimed.

## **STATE AGENCY COMMENTS**

In written comments on our draft report, the State agency concurred with our third and fourth recommendations. However, the State agency did not concur with our first recommendation to refund \$11,716,850 and our findings resulting in the recommended set-aside amount.

In response to our first recommendation, the State agency commented that it objected to any findings based on incomplete documentation for any dates before July 1, 2007, and that there should be no disallowance associated with discarded sample items:

- The State agency commented that it was under no obligation to maintain records beyond the 3-year record retention period required by Federal regulations. It also commented that none of our audit notification letters “put the State agency on reasonable notice of an obligation to retain records” for the first quarter of 2004 and the second quarter of 2005. The State agency said that it would work with CMS to discuss options for determining an appropriate refund for the two quarters.
- The State agency commented that CMS was aware of the State agency's proposed treatment of nonresponses but did not challenge or question the proposed treatment. Therefore, the State agency concluded that we were in error when we recommended a disallowance associated with discarded sample items. The State agency said that in March 2004, it submitted to CMS a revised RMTS methodology, which clearly indicated that observation forms with missing or incomplete information would be discarded from

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<sup>12</sup> The 2010 State guide approved by CMS allowed the State agency to use an alternate methodology of oversampling; therefore, discarding sample items may no longer be an issue.

the sample and that only valid forms would be included in the State agency's calculation of the statewide Medicaid percentages. The State agency said that it never received questions from CMS related to its proposed RMTS methodology and continued to administer the program under this methodology. The State agency said that it is "fundamentally unfair for OIG or CMS to criticize the State for failing to operate its program in accordance with a requirement for prior approval of the methodology that was not conveyed to the State prior to implementation."

In response to our recommendation regarding a set-aside amount, the State agency commented that it explicitly reserved the right to contest our findings in any action taken by CMS.

The State agency's comments are included in their entirety as Appendix D.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

We disagree that the State agency was under no obligation to maintain records beyond the 3-year retention period and that there should be no disallowance associated with discarded sample items.

Although Federal regulations (42 CFR § 433.32(c)) require the State agency to maintain records for 3 years from submission of a final expenditure report or longer if audit findings have not been resolved, Federal cost principles (2 CFR part 225, Appendix A, section C.1.c.) state that to be allowable, costs must be authorized or not prohibited by State or local laws or regulations. The Arizona Administrative Code, Title 9, chapter 22, section R9-22-503, requires Medicaid providers, including local education agencies, to maintain records for 5 years from the date of final payment. Therefore, records that support the allowability of school-based administrative costs claimed by the State agency are required to be retained for 5 years.

In a letter dated October 20, 2008, we notified the State agency of our audit of school-based administrative costs, which included a review of the State agency's use of contingency fee payment arrangements with consultants and the impact of those arrangements on the submission of improper claims. The audit period covered school-based administrative costs that the State agency claimed during the period January 1, 2004, through June 30, 2008. After sending the letter, we began collecting relevant records and interviewing officials from both the State agency and Maximus. After reviewing the information obtained, we narrowed the scope of our audit of school-based administrative costs to review only the RMTS methodology that the State agency used to allocate the costs.<sup>13</sup> In a letter dated March 11, 2011, we notified the State agency of our intent to continue to audit its school-based administrative costs and changed the audit period to cover through September 30, 2008. Because the State agency originally received notice of our audit on October 20, 2008, it should have retained all records relevant to school-based administrative costs for the entire audit period, which was covered by the 5-year record retention requirement.

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<sup>13</sup> We decided not to review contingency fee payment arrangements with consultants.

Because CMS did not approve the State agency's proposed RMTS methodology, the State agency should have followed the CMS guide, which required that all nonresponses be coded as non-Medicaid activities.

The State agency did not provide any information explaining its nonconcurrence with our findings that resulted in a set-aside amount.

We maintain that our findings and recommendations are valid.

# **APPENDIXES**

**APPENDIX A: SUMMARY OF DEFICIENCIES BY QUARTER**

**Legend**

<b>1</b>		Inadequate documentation to support sampling methodology
<b>2</b>		Sampling methodology not fully consistent with Federal requirements
	<b>A</b>	Inappropriately discarded sample items
	<b>B</b>	Incomplete or incorrect sample universes
	<b>i</b>	The sample universe did not include all of the employees whose salaries and wages were allocated on basis of the sample results.
	<b>ii</b>	The sample universe did not cover the entire time period, i.e., employee work hours.
	<b>iii</b>	Each sample item in the universe did not have an equal chance of being selected in the sample.

**Office of Inspector General Determinations of  
Number of Deficiencies**

<b>Year</b>	<b>Quarter</b>	<b>1</b>	<b>2A</b>	<b>2B(i)</b>	<b>2B(ii)</b>	<b>2B(iii)</b>
2004	1	x	Not applicable	Not applicable	Not applicable	Not applicable
	2		x	x	x	x
	3		x	x	x	x
	4		x	x	x	x
2005	1		x	x	x	x
	2	x	Not applicable	Not applicable	Not applicable	Not applicable
	3		x	x	x	x
	4		x	x	x	x
2006	1		x	x	x	x
	2		x	x	x	x
	3		x	x	x	
	4		x	x		
2007	1		x	x		x
	2		x	x		
	3		x	x		x
	4		x	x		x
2008	1		x	x		
	2		x	x		
	3		x	x		x
<b>Total</b>		<b>2</b>	<b>17</b>	<b>17</b>	<b>9</b>	<b>12</b>

**APPENDIX B: UNALLOWABLE AND SET-ASIDE FEDERAL REIMBURSEMENT BY QUARTER**

<b>Year</b>	<b>Quarter</b>	<b>Federal Reimbursement</b>	<b>Unallowable Federal Reimbursement</b>	<b>Set-Aside Federal Reimbursement</b>
2004	1	\$3,372,051	\$3,372,051	\$0
	2	3,802,295	766,660	3,035,635
	3	2,230,440	723,177	1,507,263
	4	2,538,436	682,456	1,855,980
2005	1	1,910,965	315,552	1,595,413
	2	2,049,660	2,049,660	0
	3	1,447,429	427,080	1,020,349
	4	700,305	149,062	551,243
2006	1	1,295,357	200,059	1,095,298
	2	885,870	192,178	693,692
	3	906,739	244,772	661,967
	4	1,681,091	580,437	1,100,654
2007	1	1,629,994	506,915	1,123,079
	2	1,308,524	362,783	945,741
	3	1,114,758	444,387	670,371
	4	690,191	55,220	634,971
2008	1	750,742	57,026	693,716
	2	1,590,419	382,975	1,207,444
	3	640,556	204,400	436,156
<b>Total</b>		<b>\$30,545,822</b>	<b>\$11,716,850</b>	<b>\$18,828,972</b>

**APPENDIX C: ORIGINAL AND REVISED STATEWIDE MEDICAID  
PERCENTAGES BY QUARTER**

<b>Year</b>	<b>Quarter</b>	<b>Sample Size</b>	<b>No. of Discarded Sample Items</b>	<b>State Agency Statewide Medicaid Percentage</b>	<b>Office of Inspector General Revised Statewide Medicaid Percentage</b>
2004	1	Not applicable <sup>1</sup>	Not applicable	8.51	Not applicable
	2	4,000	449	9.41	7.67
	3	3,500	577	11.46	7.74
	4	4,500	839	11.48	8.28
2005	1	4,000	516	8.98	7.55
	2	Not applicable <sup>1</sup>	Not applicable	8.13	Not applicable
	3	4,000	904	10.51	7.42
	4	1,200	193	6.28	4.93
2006	1	1,200	160	7.94	6.79
	2	1,200	172	4.72	3.69
	3	1,200	330	7.63	4.97
	4	1,200	347	7.75	5.07
2007	1	1,200	291	7.93	5.46
	2	1,200	267	7.23	5.24
	3	1,200	407	7.91	4.79
	4	1,200	354	2.21	2.03
2008	1	1,200	340	4.13	3.81
	2	1,200	272	7.39	5.58
	3	1,200	336	5.42	3.69
<b>Total</b>		<b>34,400</b>	<b>6,754</b>		

<sup>1</sup> We could not determine the sample size and the number of discarded sample items because of the lack of documentation. Therefore, we could not calculate the revised statewide Medicaid percentage.

## APPENDIX D: STATE AGENCY COMMENTS

Janice K. Brewer, Governor  
Thomas J. Betlach, Director

801 East Jefferson, Phoenix, AZ 85034  
PO Box 25520, Phoenix, AZ 85002  
Phone: 602-417-4000  
www.azahcccs.gov



Our first care is your health care  
ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM

August 16, 2012

Lori A. Ahlstrand  
Regional Inspector General for Audit Services  
Office of the Inspector General  
Department of Health and Human Services, Region IX  
90 - 7th Street, Suite 3-650  
San Francisco, California 94103

**RE: A-09-11-02020**

Dear Ms. Ahlstrand:

The Arizona Health Care Cost Containment System (AHCCCS) has reviewed the draft report entitled "Arizona Improperly Claimed Federal Reimbursement for Medicaid School-Based Administrative Costs." I appreciate the opportunity to provide comments on the recommendations contained in the draft report to be taken into consideration in the preparation of the final report.

The draft report recommends that AHCCCS "refund to the federal government \$11,716,850 for unallowable school-based administrative costs." AHCCCS does not concur with this recommendation. In addition the report identifies \$18,828,972 (federal share) that OIG finds unallowable but has decided to set aside for resolution by CMS. AHCCCS does not concur with the findings of the OIG audit resulting in the set aside amount and explicitly reserves the right to contest the findings in any action taken by CMS.

**No Documentation for Sample Universe Determination and/or Sample Selection**

The OIG audit identifies an issue with \$5,421,711 in unallowable administrative costs associated with missing supporting data files for 2 of the 19 quarters under review. The draft report notes that for the first quarter of 2004 and second quarter of 2005 AHCCCS is unable to provide the "data files supporting the sample universe determination and the sample selection."

The State objects to any findings based on incomplete documentation for any dates prior to July 1, 2007, of (1) the universes of total available moments in time and RMTS participants and/or (2) the sample of random moments for selected RMTS participants because the State was under no obligation to maintain those records. Pursuant to 45 CFR 92.42(b)(1) and (c), as a general rule, States are required to maintain records for a fiscal year for three years from the date the State files its final quarterly expenditure report for the fiscal year. Subsection (b)(2) of that regulation modifies the general rule to require retention for the three year period following the close of an audit "if any litigation, claim, negotiation, audit or other action involving the records has been started before the expiration of the [normal] 3-year period."

By letter dated March 11, 2011, OIG notified the State of its "intention to conduct an audit of Medicaid school-based administrative costs claimed by the State of Arizona." OIG had sent the State letters prior to that date regarding audits of (1) Medicaid services provided by local educational agencies and (2) contingency fee agreements regarding the State's compensation of its consultant on school-based administrative costs. However, none of those letters put the State on reasonable notice of an obligation to retain records regarding the State's claims for the administrative costs themselves beyond the normal three year period.

Ms. Lori A. Ahlstrand  
August 16, 2012  
Page 2

Due to the extended time frame in which the audit of the Arizona Medicaid school-based claiming program was conducted, a small portion of the supporting data has been misplaced. It is clear from the complete data files available for the other 17 quarters, the secondary data available for the two quarters in question, and the existence of completed claim calculations for the two affected quarters that data were available at the time the claim calculation was completed. Therefore, AHCCCS does not agree that the entire claim for the two affected quarters should be disallowed. The State will work with CMS to discuss options for determining an appropriate refund for the two quarters that does not unfairly penalize the Local Education Agencies (LEAs).

**Inappropriately Discarded Sample Items**

The OIG Audit identifies \$6,295,139 in unallowable administrative costs associated with “improperly discarded sample items when calculating the statewide Medicaid percentage for each quarter.” The OIG finds that the State did not adhere to the CMS guide and inappropriately discarded nonresponses from the Random Moment Time Study (RMTS) sample.

On March 23, 2004 AHCCCS submitted to CMS a revised methodology for the Medicaid Administrative Claiming program for review and approval. That methodology clearly identified the proposed treatment of RMTS forms. Forms returned with missing or incomplete information, or completed by participants not trained prior to their moment, were to be marked invalid and removed from the sample. Forms that were not returned were to be marked invalid and removed from the sample. Only valid forms would be included in the tabulation.

On November 5, 2004, prior to paying the March 2004 administrative claim, AHCCCS contacted the CMS Region IX office inquiring as to the status of the submitted methodology. A response was received from the regional office the same day stating that the methodology had been submitted to CMS Central Office for review on March 23, 2004. The email also stated that staff who had reviewed the methodology indicated that it looked good, they had only a few questions, and they understood that until the State received final approval, the program was being operated under a methodology prepared in accordance with AHCCCS’ understanding of the requirements of the claiming guide.

AHCCCS never received questions related to the March 2004 submission and continued to administer the program under the proposed methodology as suggested by the CMS Region IX office. In June 2008, when advised by the school-based program contractor that recent CMS guidance was in disagreement with the State’s interpretation of the treatment of nonresponses, the State drafted an amended methodology which was submitted to CMS for review and approval in October 2008. The State immediately implemented the changes proposed in the amended methodology to tabulate the December 2007 administrative claim. CMS provided a response to the October 2008 submission, and through the subsequent review and approval process, the State made further revisions and a methodology was finally approved for Arizona in May 2010.

The OIG draft report states “CMS central office and regional officials informed us that section V.B.2. of the guide means that State Medicaid agencies may use alternate methodologies, including oversampling, to factor nonresponses into their methodology but only with *prior* approval from CMS. That is, any alternate methodology used to compensate for nonresponses must be submitted to CMS for review and approval before implementation and must also be statistically valid and reliable” (emphasis added). Neither the Medicaid Act, its implementing regulations, nor the CMS *Medicaid School-Based Administrative Claiming Guide* require *prior* approval. At a minimum, with respect to claims after the State’s implementation of the amended methodology in October of 2008, the State is entitled to claim expenditures based on that methodology based on CMS’ approval of the methodology in May of 2010.

Ms. Lori A. Ahlstrand  
August 16, 2012  
Page 3

The purpose of an OIG audit is to determine whether the State's Medicaid program "is being operated in a cost-effective manner" and whether "funds are being properly expended for the purposes for which they were appropriated under Federal and State *laws and regulations*." 42 CFR 430.33(a) (emphasis added). In addition, 42 CFR 430.32 states that CMS reviews State administration of the Medicaid program "to determine whether the State is complying with the Federal *requirements* and the provisions of [the State's Medicaid] plan" (emphasis added). The regulations in Part 430, Subpart C "set forth State plan *requirements*, standards, procedures, and conditions for obtaining Federal financial participation." 42 CFR 430.1 (emphasis added).

To the extent that this finding is premised on statements made by CMS to OIG that approval of the protocol was required before claiming could occur – oral statements that are not supported by statute, regulation, or published guidance – the State objects to the finding. It is fundamentally unfair for OIG or CMS to criticize the State for failing to operate its program in accordance with a requirement for prior approval of the methodology that was not conveyed to the State prior to implementation. This is particularly true in light of CMS' knowledge that the State implemented the methodology while approval was pending.

AHCCCS submitted to CMS for review and approval a methodology the State believed to be a valid and reliable way to address nonresponses. The only response from CMS was generally positive with regard to the proposed methodology and indicated that CMS understood the State was operating under that methodology. When notified by the school-based contractor that more recent CMS guidance, released subsequent to the original AHCCCS methodology submission, disagreed with the State's interpretation of how non-responses could be treated, the State immediately revised its methodology and submitted those revisions to the CMS.

AHCCCS believes that the finding resulting in unallowable costs associated with inappropriately discarded sample items holds the State to a different standard than the submitted methodology under which the program was operating, a methodology never challenged or questioned by CMS. As such, it is the State's position that OIG reached this decision in error and there should be no disallowance associated with AHCCCS' treatment of nonresponses for the quarters reviewed.

#### **Strengthen Controls**

The draft report recommends AHCCCS "strengthen controls to ensure that all required documentation to support the RMTS methodology is maintained and the RMTS methodology is consistent with Federal requirements."

As discussed above, the extended time period it took to complete the Arizona school-based audit likely contributed to the misplacement of the two quarters of paper documentation associated with the very early years of the audit. Since the time period associated with the audit several changes have occurred that inherently improve the controls over program documentation, including the increased use of technology to conduct the RMTS. In addition, AHCCCS continues to monitor record retention by the LEAs and the State's contracted Third Party Administrator through operational compliance reviews.

AHCCCS concurs with this recommendation and will continue our efforts to review documentation retention to improve compliance and enhance oversight.

#### **Review Periods after the Audit Period and Make Appropriate Adjustments**

The draft report recommends that AHCCCS "review periods after our audit period and make appropriate financial adjustments for any unallowable school-based administrative costs claimed."

Ms. Lori A. Ahlstrand  
August 16, 2012  
Page 4

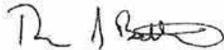
As stated earlier, AHCCCS has continued to revise the methodology for the administrative claiming program to comply with guidance from CMS. The first revision, submitted in 2008 implemented changes in quarters under review for the OIG audit. Since the end of the review period additional methodology changes have been proposed and approved by CMS.

For other issues associated with the appropriate calculation of costs claimed, AHCCCS concurs with this recommendation. AHCCCS, in coordination with our contractor, conducts regular compliance reviews of all participating LEAs. Those reviews are on-going and encompass the period after the audit timeframe. Findings of unallowable school-based administrative costs associated with those reviews result in recoupment of funds from the LEA.

In summary, AHCCCS will continue to improve oversight of the School-Based Administrative Claiming program in an effort to enhance future compliance with both Federal and state policy and program regulations.

Thank you again for the opportunity to comment on the draft OIG report. Please contact either Melinda Hollinshead, 602-417-4746, or Tricia Krotenberg, 602-417-4149, if there are any additional questions.

Sincerely,



Thomas J. Betlach  
Director

cc: Beth Lazare, Deputy Director  
Marc Leib, MD, Chief Medical Officer  
Rebecca Fields, Assistant Director, Division of Fee For Service Management  
Jim Cockerham, Assistant Director, Division of Business and Finance  
Matt Devlin, Assistant Director, Office of Administrative Legal Services