

FINAL AUDIT REPORT

Detroit Public Schools
Medicaid Administrative Outreach Claim

January 1, 2004 – December 31, 2004



Office of Audit
Lansing Regional Office
February 2006



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GOVERNOR

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DEPARTMENT OF COMMUNITY HEALTH
OFFICE OF AUDIT
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February 22, 2006

Bruce Elkins, Medicaid Coordinator
Detroit Public Schools
Division of Finance, Office of Medicaid
Fisher Building, 11th Floor
7313 Second Avenue
Detroit, Michigan 48202-2710

CERTIFIED MAIL
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Dear Mr. Elkins:

Enclosed is the final report from the Michigan Department of Community Health (MDCH) audit of the Detroit Public School's (DPS) Medicaid claim for Administrative Outreach Program (AOP) costs during the period January 1, 2004 through December 31, 2004.

The final report contains the following: description of agency; funding methodology; purpose; objectives; scope and methodology; conclusions, findings and recommendations. Attached are schedules that summarize the amounts considered allowable and unallowable, by element of expense and by claim period. The conclusions, findings, and recommendations are organized by audit objective.

Approximately \$29.8 million of the \$133 million direct and indirect costs reported during the audit period are considered unallowable. After allocations based on rates in effect as of April 25, 2005, \$723,987 of the Federal reimbursement based on those costs is considered unallowable. DPS was paid \$434,392 for its share of the unallowable costs. In our opinion, the \$434,392 paid to DPS should be refunded through withholdings from your future AOP payments.

If you agree with our findings and recommendations then no further action, other than the implementation of the recommendations, is required by DPS. The MDCH Policy Section will forward our report to the MDCH Accounting and Federal Reporting Sections where the necessary adjustments will be processed after a 30 day period for filing appeals has elapsed. If you choose your right to appeal our findings, the procedures are described below.

Appeal Procedures

If DPS disagrees with the MDCH audit findings, DPS may use the administrative review process as specified for Medicaid Provider Reviews and Hearings. To use the Medicaid Provider Reviews and Hearings, DPS must request a conference or hearing within 30 days of receipt of this notice. The adjustments presented in this final report are an adverse action as defined by MAC R 400.3401. If DPS disagrees with this adverse action, DPS has a right to request a

Bruce Elkins, Medicaid Coordinator
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preliminary conference, bureau conference or an administrative hearing pursuant to MCL 400.1 et seq. and MAC R 400.3401, et seq. The request should identify the specific audit adjustment(s) under dispute, explain the reason(s) for the disagreement, and state the dollar amount(s) involved, if any. DPS should also include any substantive documentary evidence to support their position. Requests must specifically identify whether DPS is seeking a preliminary conference, a bureau conference or an administrative hearing.

If DPS chooses to request a preliminary conference, bureau conference, or administrative hearing, the request must be sent within 30 days of receipt of this letter to:

Administrative Tribunal & Appeals Division
Michigan Department of Community Health
1033 S. Washington
P.O. Box 30763
Lansing, Michigan 48909

If DPS does not appeal this adverse action within 30 days of receipt of this notice, this letter will constitute MDCH's Final Determination Notice according to MAC R 400.3405, and we will implement the adjustments as outlined above and in this final report.

Thank you for the cooperation extended to our auditor throughout this audit process.

Sincerely,



Larry M. St. Clair, Audit Manager
Central Regional Office

LMS:wjb

Enclosure

cc: Mr. Paul Reinhart, Senior Deputy Director, Medical Services Administration

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DESCRIPTION OF AGENCY

The Constitution of the State of Michigan requires the legislature to maintain a system of free public elementary and secondary schools. In carrying out this mandate, the legislature has established different types of school districts and has delegated responsibility for their governance to local boards of education. The Detroit public school system (DPS) is officially named "School District of the City of Detroit." The boundaries of DPS are the same as those of the City of Detroit, but the DPS governance is separate and distinct from that of the City.

During CY 2004 DPS was administered by a seven-member Reform School Board. In 1999 the State legislature designated DPS as a "Qualifying School District" thereby subjecting the district to the Reform School Board. Six of the members were appointed by the Mayor of the City of Detroit; the seventh board member is the State Superintendent of Public Instruction. The Reform Board's term expired on December 31, 2005. An elected School Board was seated in January 2006.

DPS is the 15th largest school district in the nation, and the largest in Michigan.

BACKGROUND

On August 31, 2000 the Centers for Medicare and Medicaid Services (CMS) issued a disallowance letter for school administrative costs claimed for Medicaid reimbursement by MDCH. The disallowance included all costs claimed for three fiscal quarters under MDCH's school based administrative outreach program. The primary concern of CMS was that the claiming mechanism implemented by MDCH did not properly differentiate between the costs of allowable Medicaid administrative activities and unallowable activities in the school districts. Subsequent actions by CMS for similar reasons extended their deferrals and disallowances to several years of Michigan's school based service claims.

In May 2002 the United States Department of Health and Human Services, acting through CMS, entered into a settlement agreement with MDCH in the matter of the school based Medicaid administrative costs. As a result of that agreement MDCH implemented a new claims development methodology that became effective January 1, 2004. Highlights of the new methodology include:

- A random moment time study (RMTS) using the Medicaid Administrative Claiming System (MACS) software.
- New time study activities.
- Two options for claim development.
- Establishment of central administrative responsibilities related to the administration of the RMTS.
- A single method of determining a discounted Medicaid eligibility rate to be used in the MACS.
- A special monitoring system.

This new claims process may also be used to generate backcasting information for the settlement of past CMS deferrals and disallowances, based on the allowable cost claimed by MDCH under the new methodology.

MDCH contracted with Public Consulting Group (PCG) to perform random moment time studies, determine the Medicaid eligibility rate for DPS and each intermediate school district, provide training, and perform certain other functions needed to develop Medicaid claims. Each school district or consortium of districts that qualified as a Medicaid provider was free to choose PCG for completing its Medicaid claim, or to employ others to complete the claims' development. DPS has contracted with the consulting group IMED to review the responses from DPS employees sampled by PCG, and to assist in completing the Medicaid claim.

The settlement agreement required MDCH and CMS to monitor the newly developed claim procedures for at least the first two quarters of its use. For its part, MDCH hired a subcontractor (MAXIMUS) and added one position to its Office of Audit to monitor the claim development. The subcontractor reviewed all aspects of the RMTS, monitored the providers' understanding of the claim development and verified that formulas embedded within the Medicaid claim documents will generate the correct claim amounts. The auditor's function is primarily to: 1) evaluate the new AOP claims processing system; 2) determine whether the costs reported to PCG and used to develop the Medicaid claim were reasonable, allocable and allowable under Federal and State criteria; and 3) determine whether certain allocation percentages were accurate and properly applied to the districts' costs, resulting in the appropriate amounts reported for Medicaid claims and for backcasting.

FUNDING METHODOLOGY

DPS prepares its own Medicaid claims. Staff salaries and related costs are identified by the DPS accounting staff and listed on a template supplied by PCG. DPS then applies the various allocation percentages using the MACS software provided by PCG and submits the claim directly to MDCH. The Medicaid claims are submitted to the MDCH for review, processing and payment each fiscal quarter. Because CMS reimbursement policies for school based services by medical professionals have changed, the DPS must also report an informational claim amount each quarter for use in the settlement of past disallowances.

Claim development for both the informational claim and the claim for reimbursement are based on a "pool" of costs, primarily salaries, incurred by DPS for individuals that engage in Medicaid-type activities on a regular basis. The percentage of effort actually spent on Medicaid-type activities is identified by the RMTS. Reallocation of administrative activities found in the RMTS and certain other allocation percentages are applied to the Medicaid activities where appropriate. For most activities, the final amount claimed for Medicaid reimbursement is equal to:

The Cost Pool X the RMTS % X the % of students enrolled in Medicaid
X (100% + Approved Indirect Cost Rate) X Federal Financial Participation
(FFP) Rate

The percentage of students enrolled in Medicaid does not apply to outreach activities nor assisting with eligibility determinations, and therefore that factor is not applied to the costs for those activities. Other adjustments are made for the informational claim, to increase the FFP rate for any medical professional salaries and related fringe benefit costs, for the settlement of past disallowances.

PURPOSE AND OBJECTIVES

The primary purpose of our audit was to determine whether \$6,907,848 (\$3,453,924 – Federal share) of administrative costs claimed by DPS for Medicaid reimbursement for January 1 through December 31, 2004 and the \$3,908,879 – Federal share reported for backcasting, are reasonable, allocable and allowable using the methodology approved by CMS. These were the amounts claimed as of April 25, 2005, the latest claim revision received by the MDCH. The claimed costs were the result of applying various allocation percentages to an \$111,750,077 (direct) cost pool identified by DPS.

Our work is summarized by the following objectives:

1. To determine whether the cost pool used to develop the Medicaid claim contained only costs considered reasonable, allocable and allowable under Federal and State criteria.
2. To determine whether certain allocation percentages were accurately calculated and properly applied to the DPS costs, resulting in the appropriate amounts reported for Medicaid claims and for backcasting.

SCOPE AND METHODOLOGY

Within the limitations described below, our audit included reviews of the claims development process and the costs claimed by DPS for the calendar year ended December 31, 2004 as revised by a claim submitted April 25, 2005.

The scope of our review of the claims development process was limited to parts of the process that were not monitored by others. The RMTS and the assignment of sampled moments to activities were monitored by MAXIMUS and CMS and, therefore, were excluded from the scope of this audit. We also accepted the Federally-approved indirect cost rate without review, but verified that the approved rate was used in claim calculations and applied only to costs in the specified base. We did not audit the procedures used to calculate the percentage of Medicaid eligible students in DPS since these procedures apply to all districts' claims, and were subsequently reviewed and approved by CMS. School districts are subject to Federal single audit requirements, and the independent auditors' reports on internal controls were used to identify weaknesses that might affect our review.

The scope of the cost pool segment of our audit was generally limited to determining if the amounts reported by DPS were (1) allowable under State policies and Federal regulations, (2) allocable to the Medicaid program and (3) properly allocated using the percentages developed by others.

Our tests included judgmental samples of the costs used by DPS in calculating its Medicaid claims as well as certain cost revisions DPS prepared for our audit. We verified the costs were directly related to individuals included in the RMTS, incurred during the sample period, did not duplicate costs claimed indirectly, were not claimed as costs of other Federal projects and were otherwise allowable under the Federal regulations in OMB Circular A-87. In determining when costs were incurred, we accepted the “modified accrual” basis used for DPS’ annual financial statements. Expenditures were recognized when paid, except payments made up to two months after their fiscal year end June 30, 2004 for FYE 2004 obligations were recognized as expenditures of FYE 2004.

We also verified 1) the accuracy of allocation percentages based on the number of moments assigned to each activity, and 2) that all allocation percentages were properly applied. Our review of internal controls included gaining a general understanding of the control procedures for costs included in the cost pool. Fieldwork was performed from June 2005 through November 2005 at the central offices of DPS in Detroit, Michigan.

CONCLUSIONS, FINDINGS AND RECOMMENDATIONS

FINANCIAL REPORTING

Objective 1: To determine whether the cost pool used to develop the Medicaid claim contained only costs considered reasonable, allocable and allowable under Federal and State criteria.

Conclusion: The DPS cost pool included: (1) salary and supply costs that were a) not documented by accounting records as required by Federal regulations, b) documented but not claimed and/or, c) funded by other Federal grants and therefore unallowable under both State and Federal criteria (Finding 1); (2) fringe benefits claimed at a rate higher than was paid in CY 2004 (Finding 2); (3) costs for interpreters that provided no benefit to AOP (Finding 3); (4) supply and support worker costs incurred to support other Federal programs (Finding 4).

Most errors were directly caused by computer applications that no longer functioned as intended. The absence of DPS review of the resulting cost reports allowed the errors to continue. The composition of the AOP staff pool, also discussed under Objective 2, exacerbated the problems by including dozens of employees that worked entirely for other Federal grants while other, eligible, staff were considered support or contract workers. Recommended corrective actions are presented after each of our Findings described below.

The net effect of each finding on the reported costs is summarized on Schedule B of this report. The effects of our findings on each of the five DPS cost reports used to prepare their Medicaid claims are shown in Schedules B1 through B5. Overpayments to DPS that resulted

from each finding are summarized on Schedule A – 1. The total effect of all findings on the Medicaid claims, amounts reported for backcasting, and the payments made to DPS for each CY 2004 claim period is on Schedule A.

Finding

1. Unsupported, Unreported or Federally Funded Salaries and Supplies

DPS reported (net) \$16.4 million in salary and supply costs that were not documented or were funded by other programs in violation of MDCH policy and OMB Circular A-87. Over \$8 million of additional, unallowable costs reported by DPS were offset by allowable salaries and supplies that went unreported.

Computer applications used by DPS to extract AOP salaries, contractor payments and supply costs from their accounting records provided erroneous results which were used, without review, for AOP cost reports. Our sampling of the costs claimed found, among other things, 1) costs funded by other Federal programs and therefore unallowable for AOP cost reports, 2) staff salaries reported for CY 2004 that were more than the employee earned for the year, 3) no salary reported for AOP staff paid allowable wages, and 4) contractual services and supply costs that could not be documented by DPS. Some employees were both 100% funded by other grants and had more salaries reported than they earned.

Faced with these results, DPS determined its computer applications were effectively obsolete or corrupted. The computer program being used to identify “allowable” AOP salaries had been written eight years earlier, for a different computer system and under the predecessor Outreach Program that was deemed unacceptable by CMS. The author of the computer program was no longer employed by DPS, making access and interpretation of program commands difficult. Supplies and other non-payroll, direct costs were identified through a newer computer application that was not write-protected. DPS found it had been modified from its original writing, probably for some different purpose, and saved under the same name.

Rather than attempt to identify and correct all the errors in the original programs, DPS developed new computer programs to identify for us the correct AOP worker earnings, support costs and any amount that was Federally funded. Our review of the revised costs confirmed the new computer applications identified the correct amounts, in total and by funding source.

Comparison of the revised, auditable costs to those originally reported found approximately \$16.4 million more was claimed than the (locally funded) cost identified by the new computer programs. To determine how much of the excess claim was caused by claiming Federally funded salaries and how much was caused by other program failures we assumed all Federally funded salaries were included in the original AOP claims. Our assumption is supported by finding 99 of the 960 staff salaries claimed in the first quarter were entirely funded by other Federal programs; the AOP staff changed little throughout the audit period. On that basis we believe that few, if any, Federally funded

costs were removed by the obsolete computer program. All remaining differences between costs claimed and the costs listed by the revised DPS computer applications are simply not supported by accounting records, or improperly excluded from the DPS claim, due to programming malfunctions.

Federally funded costs are specifically disallowed in AOP claims by MDCH policy. The MDCH School Based Services (SBS) policy (section 6.12 of the SBS AOP policy published in the current MDCH Medicaid Provider Manual) states:

...Claims for approved Medicaid SBS administrative outreach functions may not include expenditures of:

- *Federal funds received by the district directly*
- *Federal funds that have been passed through a State or local agency....*

Federal regulations disallow both Federally funded and unsupported (“undocumented”) costs. Attachment A of OMB Circular A-87 contains the basic federal guidelines for determining the allowability of costs. Paragraph C. states, in part:

1., To be allowable under Federal awards, costs must...

h. Not be included as a cost...of any other Federal award...

j. Be adequately documented....

We found the direct costs used by DPS for their claim calculations included approximately \$24 million that was either included as a cost of another Federal award or not documented. Our recommended adjustments (partially) offset these unallowable costs with about \$8 million of allowable salaries and other costs that were omitted by the DPS computer applications. Exact amounts are presented in the report Schedules.

The lack of cost report review by anyone at DPS was conspicuous:

- Over 10% of the AOP staff listed were funded entirely by other Federal grants, but no one noticed.
- The third cost report of CY 2004 listed no salary for about 20% of the staff (210 employees). Any review of the absent salaries would have disclosed 1) less than 20 staff were actually paid nothing in that report period, and/or 2) that staff employees were working for other Federal grants. Corrective action would be indicated for either finding.
- Over three times as much supply cost was reported for the fourth quarter as reported for the rest of the year combined, and the cost was claimed without question.
- Over \$1 million more contracted staff cost was claimed in the fourth quarter than for the prior nine months.

Yet no one even verified the totals provided by the (corrupted) computer program were the same as those reported for the Medicaid claim calculations. We found the computer formulas used to add the non-payroll costs in the cost report did not extend to the bottom of the report. Had the amounts listed on the cost report been added correctly, an additional \$281,000 of undocumented supply and contract costs would have been claimed.

During the period of our site visits we noted great progress by DPS, not only in their ability to identify allowable AOP costs but also in the development of tools that will be required to monitor future cost reports. As we reported, the new computer programs written by DPS were found to properly identify the non-Federal costs in their accounting records. Furthermore, DPS developed a payroll distribution program that can identify the project(s) charged with earnings, each pay period, for any employee. The project identification number indicates whether a specific Federal or other program is funding the employee's salary. Certain policies and procedures have been written which are being implemented for current claim submissions.

Recommendations

We recommend that DPS:

- 1.) Use its new computer programs to prepare and revise its claims for AOP costs incurred after CY 2004.
- 2.) Review each cost report prior to calculating Medicaid claims. At a minimum DPS should:
 - a.) Verify that all locally funded costs identified by the computer programs are included in the cost reports. Obtain satisfactory explanations for differences.
 - b.) Compare cost reports to prior cost reports and/or amounts in this report to identify any significant deviations from the "normal" amounts claimed. Determine the appropriateness of any large differences.
 - c.) Identify the reason(s) any AOP staff have no salary listed on the cost report. Any employee identification numbers inadvertently omitted from the computer applications would cause no salary to be listed, with a resulting Medicaid under claim. Changes in the employee's funding to 100% Federal, or in their employment status (retirement, dismissal, etc.) could also cause no salary to be reported, and would suggest their deletion from future staff lists.
- 3.) At least annually test the continued functionality of its computer applications.

We recommend that MDCH:

- 1.) Revise its Medicaid claims for Detroit's AOP services as shown in Schedule A.
- 2.) Withhold \$270,313 (computed on Schedule A - 1) from the next DPS claim payment(s) to recover the net amount overpaid for the Federally funded, unsupported and unreported costs.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

Finding

2. Unsupported Fringe Benefits Reported

DPS used an unsupported fringe benefit rate to calculate employee benefit costs, resulting in a \$4,079,706 overstatement of fringe benefits in their AOP cost report.

New fringe benefit rates were developed for us by DPS, supported by accounting records. Comparison of the fringe benefit costs, as reported, to the cost calculated using the new rates found \$4,079,706 more included in the Medicaid claim calculation than could be

documented. Approximately \$600,000 of the indirect cost claimed was based on the unsupported cost of benefits. Undocumented costs are not allowable for Federal reimbursement, according to the same Circular A-87 excerpt as cited in Finding 1.

The fringe benefits on AOP cost reports were generally equal to 42% of the salaries reported. We were informed this was the (rounded) percentage used district-wide for pricing fringe benefits in all cost reports. However, the person that developed the rate had left DPS employment and we could find no one who could explain the basis for the historical rate.

DPS financial statements for the FYE June 30, 2004 indicated that fringe benefits actually cost approximately 36% of salaries that year. It is not unusual for negotiated fringe benefit rates to be higher or lower than actual cost, due to roll-forward adjustments that correct poor estimates made in a prior year. However, we found no evidence the fringe benefit rate used by DPS had ever been submitted to the MDE or the Federal authority for negotiation and approval. In the absence of an approved rate, only the documented fringe benefit cost for AOP staff and support workers is allowable.

DPS identified for us the actual salaries and fringe benefits paid in CY 2004. Their report included costs and rates by union affiliation, and for two semi-annual periods in the calendar year. The semi-annual rates were developed to account for any changes between the FYE June 30, 2004 contracts and those negotiated for FYE June 30, 2005. Because most AOP staff belongs to the Detroit Federation of Teachers, we accepted fringe benefit rates based on their costs: 36.56% during the first six months of 2004 and 35.63% for the remainder of the year. Application of these rates to the salaries reported on the DPS cost reports results in approximately \$4 million less fringe benefit cost than reported by DPS. The indirect cost related to the unallowable benefits (at 15% of total direct costs) is approximately \$600,000.

In our opinion, the use of a fringe benefit rate is appropriate for DPS and we have accepted costs based on the revised rates. However, fringe benefit rates used for claiming Federal reimbursement generally require the same negotiation and approval as the indirect cost rates used on Federal grants or contracts. This is discussed in Attachment E of OMB Circular A-87, as follows:

...F. Other Policies

1. Fringe benefit rates. If overall fringe benefit rates are not approved for the governmental unit as part of the central service cost allocation plan, these rates will be reviewed, negotiated and approved for individual grantee agencies during the indirect cost negotiation process. In these cases, a proposed fringe benefit rate computation should accompany the indirect cost proposal....

Because MDE has been delegated the Federal authority to negotiate and approve school district indirect cost rates, we believe they also have the authority and responsibility to approve fringe benefit rate proposals from DPS.

Recommendations

We recommend that DPS:

- 1.) Assign an individual responsible for annual fringe benefit rate calculations.
- 2.) Annually submit proposed fringe benefit rate calculations to MDE, along with the indirect cost rate proposal, for their review and approval.
- 3.) Revise its claims for periods after CY 2004 to include only allowable fringe benefits.

We also recommend that MDCH:

- 1.) Revise its Medicaid claims for Detroit's AOP services as shown in Schedule A.
- 2.) Withhold \$67,425 (computed on Schedule A – 1) from the next payment scheduled for DPS, to recover payments based on the unallowable fringe benefits claimed for CY 2004.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

Finding

3. Costs Claimed For Contractors That Provided No Medicaid Benefit

DPS claimed \$804,854 in costs for contracted interpreters and related indirect costs that provided no benefit to Medicaid administration.

One criterion for determining whether a cost is allowable for Federal reimbursement is that benefit must be received by the Federal grant or contract (Circular A-87, Attachment A, paragraph C.3.). Because we found no benefit to Medicaid administration, the interpreter costs claimed are considered unallowable for reimbursement by the Medicaid Administrative Outreach Program.

During CY 2004 interpreters were an acceptable job category for inclusion on AOP staff lists. The interpreters were sampled as part of the RMTS, and their costs were generally included in the pool of costs allocated by the RMTS percentages. However, after analyzing sample results for the year, PCG and MDCH recommended the category be removed from future staff lists and cost reports. They found interpreters had performed no Medicaid administrative work. In effect, none of the interpreter costs were being allocated to Medicaid claims because the RMTS found no sampled moments that benefited Medicaid administration.

DPS did not include interpreters on its staff list. They had the mistaken belief that all outside contractors were not included in the RMTS and, because all DPS interpreters were hired from private contractors, none were included on the list of sample participants.

Had DPS included the contracted interpreter positions on the AOP staff list, the payments to the contractors could have been included in the pool of costs allocated by the RMTS percentages. However, the available evidence indicates the statewide percentage of allowable Medicaid cost would also have been lowered by their inclusion in the RMTS. In a theoretically perfect sample, the statewide percentage would be reduced enough to

eliminate all interpreter cost that did not benefit Medicaid administration. In effect, the cost would not have been allocated to Medicaid and would not have been claimed for Federal reimbursement. Because the DPS interpreters were not in the RMTS, their costs were allocated to Medicaid claims based on samples of other positions that did perform some Medicaid administrative function.

After allocations, the \$804,854 of DPS interpreter costs added \$44,339 (\$22,170 Federal share) to the DPS Medicaid claims. It is not possible to go back in time and include the DPS interpreters in the RMTS, recalculate the allowable Medicaid percentages from the RMTS and allow the payments DPS made for interpreters. However, we can estimate that the effect would be to reduce the statewide Medicaid claim by \$44,339 for the \$804,854 of interpreter costs that did not benefit the Medicaid program. Since the reporting error was made by DPS, the recovery must also be from the DPS claims.

Recommendations

We recommend that DPS exclude the costs for interpreters from all AOP claims made for periods after CY 2004.

We also recommend that MDCH:

- 1.) Revise its Medicaid claims for Detroit's AOP services as shown in Schedule A.
- 2.) Withhold \$13,302 (computed on Schedule A – 1) from the next payment scheduled for DPS, to recover the payments made for unallowable interpreter costs claimed for CY 2004.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

Finding

4. Support Costs Allocable To Other Federal Grants

DPS did not allocate an estimated \$651,702 of support costs to the other Federal grants that funded the work of AOP staff participants.

Because the computer programs used by DPS did not properly identify salaries by their funding source (see Finding 1) it was not possible for DPS to identify the portion of support costs that benefited AOP versus other work at DPS. We estimate that \$651,702 of the support costs in the DPS Medicaid claim calculations were spent supporting other Federal grants and contracts.

Federal regulations indicate that the cost of supporting work on the other Federal projects is allocable only to the grant or contract that benefited from that work. This is true whether or not the Federal grant that benefits from the work will pay for it. The regulations are presented in Attachment A of OMB Circular A-87, paragraph C:

...3. *Allocable costs.*

a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received....

c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons....

The AOP staff lists from DPS inadvertently included about 100 employees that were funded 100% by Federal grants other than Medicaid. As previously reported in Finding 1, the error went unnoticed because a faulty computer program failed to identify and exclude the federally funded salaries from AOP cost reports. These employees were not eligible for the AOP staff pool list according to PCG's Financial Reporting Procedures (page 15), which states:

...Staff who are 100% federally funded should not be included on the staff pool list...

The costs to support DPS employees that cannot be part of the Administrative Outreach Program cannot be claimed as AOP costs. Because DPS did not know that any employees on its staff list were working for other Federal programs, all costs for supporting the listed staff were claimed.

According to Circular A-87 the costs must be allocated to the program that benefited from the support. The requirement applies to the support of employees that work part time for other Federal grants as well as the support of employees that worked full time for the other grants.

Our allocations are shown on Schedule C of this report. The revised DPS computer program found that between 10% and 14% of the salaries paid to employees on the AOP staff list each claim period were funded by other Federal grants. We used this to estimate the percentage of supply costs and support worker salaries spent for the other grants. Once the cost of supplies used by AOP staff was identified, we simply applied the funding percentages to estimate the amount spent in support of other Federal grants; none of the supplies were charged to the other grants. The calculation was similar for support worker salaries, except that some of the cost to support the other Federal grants was paid by the other grants. The cost *used* by other grants in excess of the cost *paid* by other grants is allocable only to those other grants. The remaining costs, paid from local revenues, are accepted for the AOP claim.

Recommendations

We recommend that DPS revise its claims for periods after CY 2004 to include only the locally funded costs that were not spent to support other Federal grants.

We recommend that MDCH:

1.) Revise its Medicaid claims for Detroit's AOP services as shown in Schedule A.

- 2.) Withhold \$10,771 (computed on Schedule A – 1) from the next DPS claim payment(s) to recover the net amount overpaid for the costs allocable to other Federal projects.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

ALLOCATION PERCENTAGES

Objective 2: To determine whether certain allocation percentages were accurately calculated and properly applied to the reported DPS costs, resulting in the appropriate amounts reported for Medicaid claims and for backcasting.

Conclusion: We found the Medicaid claims, the amount requested for Federal reimbursement and the amount reported for backcasting were not always calculated based on the correct allocation percentages. The two claims for the fiscal quarter ended September 30, 2004 were calculated using a 39.55% indirect cost rate although MDE, the cognizant agency for school indirect cost rates, had established a limit of 15% on all indirect costs (Finding 5); the claim for the fiscal quarter ended December 2004 was calculated using RMTS rates developed for the prior period claims (Finding 6); and staff lists were not accurate, which may effect the percentage of allowable Medicaid activity determined by the RMTS (Finding 7).

Finding

5. Unapproved Indirect Cost Rates Used In Claim Calculations

DPS used an unauthorized indirect cost rate to calculate the two claims for the summer fiscal quarter (July 1, 2004 through September 30, 2004), which resulted in unallowable Medicaid claims of \$222,772 (\$111,386 – Federal share).

The Federal government allows reimbursement for indirect costs claimed in accordance with approved cost allocation plans or indirect cost agreements. To avoid confusion and duplication of effort, only one Federal agency or its delegate is given the authority to negotiate and approve the indirect cost agreements for use at each organization. Claims by an organization for indirect costs under any Federal agency's grant or contract are limited to the rate(s) approved by the one, cognizant agency.

The authority to establish indirect cost rates for the local education agencies (LEAs) in Michigan has been delegated by the Federal government to the State Superintendent of Public Instruction or his/her representative, i.e.: the MDE. The Delegation Agreement was made with the general understandings that indirect cost rates would be established using the fixed with carry-forward methodology, and:

...Whenever this yields a rate greater than 15.0% of Modified Total Direct Costs (MTDC), the rate awarded and applied will not be greater than 15.0% of MTDC....

The MDE has consistently adhered to this understanding and limited the approved indirect cost rates for all LEAs to 15% of MTDC.

During CY 2004 the MDCH and an AOP advisory group sought to have the 15% rate limitation removed for purposes of claiming Medicaid administrative costs. The CMS indicated it would have no objection to eliminating the 15% “cap” for Medicaid claims and, without authorization from MDE, the MDCH revised its policy to allow the use of uncapped rates for AOP claims.

The MDE never did authorize LEA indirect cost rates in excess of 15%, but PCG supplied claim templates to DPS for the (summer) quarter ended September 30, 2004 that included the 39.55% uncapped rate for DPS.

By CY 2005 it became apparent the cap would not be lifted at any time in the near future, and the MDCH policy reverted to use of indirect cost rates limited to 15%. However, claim calculation templates supplied by PCG in March 2005 for summer quarter claim revisions retained the 39.55% rate previously used. The lack of cost report review by DPS, reported in Finding 1 above, allowed the incorrect rate to remain in their Medicaid claim calculations.

Recommendations

We recommend that DPS establish a procedure to routinely review its cost reports for periods after CY 2004 to assure the correct indirect cost rates are used to calculate Medicaid claims.

We recommend that MDCH:

- 1.) Revise its Medicaid claims for Detroit’s AOP services as shown in Schedule A.
- 2.) Withhold \$66,831 (computed on Schedule A – 1) from the next DPS claim payment(s), to recover the net amount overpaid by MDCH for indirect costs that were claimed at the uncapped rate.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

Finding

6. Improper RMTS Rate Used In Claim Calculations

PCG provided DPS with incorrect RMTS rates for use in calculating the quarter ended December 2004 claim and backcasting data, resulting in a Medicaid claim overstated by \$19,168 (\$9,584 – Federal share).

In its role as the State’s AOP contractor PCG supplies cost report templates to each school district for each claim period. The templates include a list of the staff in the population PCG sampled for the RMTS, the district’s indirect cost rate, the support workers previously claimed and certain other data. Blank columns are included for the district to add the salaries, fringe benefits, supplies and other costs related to the listed staff or their support. When PCG is also a district’s billing agent, the completed cost

reports are returned to PCG for claim development. PCG combines the reported direct and indirect costs, applies the Medicaid Eligibility Rate (MER) and RMTS rates it developed as the State contractor and files a Medicaid claim for the district.

PCG is not the billing agent for DPS. However, only PCG knows the MER and RMTS rates it has developed as the AOP contractor. To make this data available for DPS to use, a claim template is provided for DPS to calculate its Medicaid claim.

We found the claim template supplied to DPS for its quarter ended December 2004 claim had not been updated to include the RMTS results for that quarter. Instead, the rates used for the prior claim period were incorporated into the December claim template. Our contact with PCG verified that inclusion of the prior period's rates was an oversight by their staff and unintentional. DPS unwittingly used this improper template to calculate their Medicaid claim.

Recommendations

We recommend that MDCH Policy:

- 1.) Request that PCG establish a procedure to assure the correct RMTS results are provided to DPS,
- 2.) Request PCG's SAS 70 auditors to review the adequacy of the new procedure during their next audit,
- 3.) Adjust the Medicaid claim as shown on Schedule A, and
- 4.) Withhold \$5,750 from a future DPS payment to recover the amount overpaid.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

Finding

7. Errors and Omissions in the AOP Staff Participant Listing

DPS erroneously included some employees and erroneously omitted some employees and contracted workers from the AOP staff lists, which may impact the RMTS and allowable AOP activity reported in Michigan.

DPS included approximately 100 employees on their staff list each quarter that were not eligible for AOP because they worked full time for other Federal grants. Additionally, DPS claimed the supervisors of eligible AOP staff as support workers although, in our opinion, it was more proper to include them in the RMTS. Finally, DPS did not list a few contracted workers as sample participants although they appeared to work full time in AOP positions. It is impossible to accurately determine the effect these errors and omissions had on the State-wide RMTS results, but we believe the tendency was to slightly understate the allowable AOP activity in Michigan. Details of the three recommended types of staff list adjustments are discussed below.

- a) Staff funded by other grants. PCG's Financial Reporting Procedures (page 15) states:

...Staff who are 100% federally funded should not be included on the staff pool list...

An oversight in selecting employees as AOP staff, as well as the faulty computer program and lack of review discussed previously, resulted in DPS including 100% federally funded staff on their staff pool list. Approximately 10% of the staff pool list was comprised of the ineligible employees. We found no indication the federally funded employees did any more or less AOP work than their locally funded counterparts and, therefore, we believe their inclusion may have had a relatively neutral effect on the RMTS results.

b) Supervisory employees claimed as support workers. PCG's instructions regarding support staff (page 12 of Financial Reporting Procedures) state:

...Support Staff include any administrative support individual tied directly to a specific individual or group of individuals (ex. Counselors) listed on the Staff Participant worksheet. Support staff are administrative assistants and secretaries....

In our opinion, the intent was to allow schools to claim the costs of employees that work **for** the AOP staff pool. We believe support staff are employees that provide benefit to AOP but would have difficulty responding to questions in a RMTS. Secretaries, for example, might have a difficult time discerning whether their typing or filing involved a reimbursable activity such as health services policy development. Allocation of such salaries based on their supervisors' responses to the RMTS allows the claim for support staff costs without direct sampling of the support workers' time.

DPS had a more literal interpretation of PCG's instructions. Because of its size, DPS employed supervisors and directors to oversee many of the AOP staff located throughout Detroit's 200 schools. These supervisory positions were administrative support for the Superintendent and directly tied to individuals listed as Staff Participants. Because this appeared to meet PCG's definition of support staff, none of the supervisory positions were included as a staff participant in the RMTS.

We confirmed our interpretation of PCG's instructions in talks with representatives from CMS, MDCH Policy and PCG. Our consensus opinion is that DPS should include the supervisory employees on future staff lists. Because supervisors in general are heavily involved in administration, we believe their inclusion in the RMTS will tend to increase the percentage of Medicaid administrative activity found in state-wide samples.

c) Contracted workers. The AOP cost report templates provided to school districts include a column to report contracted staff cost, but only on the staff participant worksheet. PCG's instructions (page 10 of 15) state that contracted staff costs are allowable:

...For those participants that are not paid a salary/hourly wage but, rather are paid through a contract... (emphasis added by Office of Audit)

The clear intent was to allow school districts to claim the costs of contracted staff that filled positions the district listed as AOP staff participants in the RMTS.

DPS spent approximately \$2 million for contracted nurses and physical therapists during CY 2004, but only DPS employees were included on its AOP staff list. Our samples indicate contracted workers generally serve as temporary replacements for the listed employees and therefore need no separate identification on the staff list. However, some contracted nurses appear to work for extended periods in positions that could not be filled by direct employment. In our opinion these positions should be identified and separately listed for inclusion in the RMTS. Because we believe few positions were involved, the RMTS results in CY 2004 may not have been affected.

Recommendations

Although circumstantial evidence indicates the errors and omissions in the DPS staff list may have had little, if any, effect on the CY 2004 time studies, we must recommend that DPS revise future lists to 1) exclude employees that work full time for other Federal grants and 2) include supervisors and the AOP positions filled by contracted staff.

Auditee Comments

DPS had no additional comments to add regarding this Finding and the related recommendations.

GLOSSARY OF ACRONYMS AND TERMS

- AOP - Administrative Outreach Program
- CMS - Centers for Medicare & Medicaid Services (the Federal Medicaid agency)
- DPS - Detroit Public Schools
- FFP - Federal Financial Participation (the portion of claimed cost Federally reimbursed)
- ISD - Intermediate School District
- LEA - Local Education Agency (a local school district)
- MACS - Medicaid Administrative Claiming System
- MDCH - Michigan Department of Community Health (the State Medicaid agency)
- MDE - Michigan Department of Education
- PCG - Public Consulting Group - the current State contractor for the AOP RMTS
- RMTS - Random Moment Time Study
- SBS - School Based Services

SUMMARY OF AUDIT RESULTS - MEDICAID COST CLAIMED and RECOMMENDED ADJUSTMENTS

		January 1 through March 31, 2004 (1st Quarter)	April 1 through June 30, 2004 (2nd Quarter)	July 1 through August 31, 2004 (Quarter 3A)	Sept. 1 through Sept. 30, 2004 (Quarter 3B)	October 1 through Dec. 31, 2004 (4th Quarter)	Calendar Year 2004 Totals
	<u>NOTES</u>						
Medicaid Claim as Submitted by DPS		\$2,369,996	\$1,470,468	\$562,698	\$778,846	\$1,725,840	\$6,907,848
Allowable Medicaid Claim per Audit	NOTE 1	<u>1,890,451</u>	<u>1,304,828</u>	<u>797,814</u>	<u>387,369</u>	<u>1,079,412</u>	<u>\$5,459,874</u>
Recommended Adjustments To:							
Medicaid Costs Overclaimed (Underclaimed)	NOTES 2 & 3	\$479,545	\$165,640	(\$235,116)	\$391,477	\$646,428	\$1,447,974
Federal Financial Participation (FFP) Rate	NOTE 4	X 50%	X 50%	X 50%	X 50%	X 50%	X 50%
Federal Share of the Overclaim (Underclaim)	NOTE 4	\$239,773	\$82,820	(\$117,558)	\$195,739	\$323,214	\$723,987
Percentage paid to DPS		X 60%	X 60%	X 60%	X 60%	X 60%	X 60%
Total Amount Overpaid (Underpaid) to DPS		<u>\$143,864</u>	<u>\$49,692</u>	<u>(\$70,535)</u>	<u>\$117,443</u>	<u>\$193,928</u>	<u>\$434,392</u>

Notes to Schedule A

- NOTE 1: These are the Medicaid administrative costs calculated by applying the Medicaid Eligibility Rates (MERs), the allowable indirect cost rates, and the Random Moment Time Study (RMTS) percentages to the allowable direct costs shown on Schedules B - 1 through B - 5.
- NOTE 2: The RMTS results from Quarter 3B were inadvertently supplied to DPS by the State's contractor (PCG) for use in calculating the Quarter 4 claim. We found approximately \$19,168 of the Medicaid cost overclaimed in Quarter 4 was caused by PCG supplying the incorrect RMTS percentages and not the result of the unallowable costs listed in Schedules B - 1 through B - 5. Further details are presented in report Finding 6.
- NOTE 3: The portion of the total recommended adjustment for each report Finding is shown on the next page, Schedule A - 1.
- NOTE 4: Reimbursement for the salaries of skilled medical professionals (SMPs) has historically been at a 75% FFP rate. During CY 2004 CMS did not allow the 75% FFP rate for SMPs in school districts. However, the claims in CY 2004 may be used for "backcasting", to estimate the allowable reimbursement for AOP claims during years when CMS did allow the 75% rate for school based SMPs. Therefore, the MDCH has requested school districts and PCG to also report, as information only, the Federal share of AOP expenditures if calculated using the higher FFP rate for SMPs.

The informational amounts reported by DPS, the effect of our findings on those amounts, and the amounts per our audit are:

FFP reported by DPS - for "backcasting"	\$1,365,561	\$843,438	\$316,255	\$425,085	\$958,540	\$3,908,879
Effect of audit findings	<u>(276,305)</u>	<u>(95,009)</u>	<u>142,708</u>	<u>(209,878)</u>	<u>(332,038)</u>	<u>(770,522)</u>
Adjusted Federal share, per audit	<u>\$1,089,256</u>	<u>\$748,429</u>	<u>\$458,963</u>	<u>\$215,207</u>	<u>\$626,502</u>	<u>\$3,138,357</u>

EFFECT OF EACH REPORT FINDING ON THE MEDICAID CLAIM AND PAYMENTS MADE TO DPS

	Calendar Year 2004 <u>Totals</u> (per Schedule B)	Finding Totals - Including related <u>indirect costs</u>	Percentage of the total cost adjustment <u>in each Finding</u>	<u>Effect of Each Finding on the Schedule A Totals for:</u>		
				<u>Medicaid Costs Overclaimed</u> (Finding % X Total)	<u>Federal Share Overclaimed</u> (@ 50% FFP)	<u>Overpayment to DPS</u> (@ 60% of FFP)
Recommended Adjustments For:						
Direct Costs:						
Costs Funded by Other Federal Grants	\$10,123,975	\$11,642,571	39.034%	\$557,725	\$278,862	\$167,317
Unsupported (Unreported) Salaries	(1,714,218)	(1,971,351)	-6.609%	(94,435)	(47,218)	(28,331)
Unsupported (Unreported) Supply and Other Costs	<u>7,946,257</u>	<u>9,138,195</u>	<u>30.638%</u>	<u>437,755</u>	<u>218,878</u>	<u>131,327</u>
Sub-total: Unsupported, (Unreported) & Federally Funded Costs - Report Finding 1	\$16,356,014	\$18,809,416	63.06%	\$901,045	\$450,522	\$270,313
Unsupported Fringe Benefit Rate Report Finding 2	4,079,706	4,691,661	15.73%	224,749	112,374	67,425
Contracted Interpreters Report Finding 3	804,854	925,582	3.10%	44,339	22,170	13,302
Unallocated Support Costs Report Finding 4	<u>651,702</u>	<u>749,458</u>	2.51%	<u>35,902</u>	<u>17,951</u>	<u>10,771</u>
Sub-total, Direct costs	\$21,892,276	\$25,176,117	84.41%	\$1,206,034	\$603,017	\$361,810
Indirect Costs:						
Use of Uncapped Indirect Cost Rate Report Finding 5	4,650,383	4,650,383	15.59%	222,772	111,386	66,831
Indirect cost related to Direct Cost Findings (@ 15% of direct cost)	<u>3,283,841</u>	<u>(in totals above)</u>	<u>0.00%</u>	<u>0</u>	<u>0</u>	<u>0</u>
Sub-total, Indirect costs	<u>\$7,934,224</u>	<u>\$4,650,383</u>	<u>15.59%</u>	<u>\$222,772</u>	<u>\$111,386</u>	<u>\$66,831</u>
Total Recommended Adjustments to Reported Costs per Schedule B	<u>\$29,826,500</u>	<u>\$29,826,500</u>	<u>100.00%</u>	\$1,428,806	\$714,403	\$428,642
Use of incorrect RMTS percentages Report Finding 6				<u>19,168</u>	<u>9,584</u>	<u>5,750</u>
Total Recommended Adjustments to Medicaid Claims, per Schedule A				<u>\$1,447,974</u>	<u>\$723,987</u>	<u>\$434,392</u>

Schedule B

SUMMARY SCHEDULE OF COSTS AUDITED, RECOMMENDED FOR ADJUSTMENT, AND ACCEPTED

		January 1 through March 31, 2004 <u>(1st Quarter)</u>	April 1 through June 30, 2004 <u>(2nd Quarter)</u>	July 1 through August 31, 2004 <u>(Quarter 3A)</u>	Sept. 1 through Sept. 30, 2004 <u>(Quarter 3B)</u>	October 1 through Dec. 31, 2004 <u>(4th Quarter)</u>	Calendar Year 2004 Totals
	<u>NOTES</u>	(\$)	(\$)	(\$)	(\$)	(\$)	(\$)
Costs Used in DPS Claim Calculations:							
Direct Costs		32,703,930	25,598,049	6,984,806	11,957,690	34,505,602	111,750,077
Indirect Costs		<u>4,905,590</u>	<u>3,839,710</u>	<u>2,762,491</u>	<u>4,729,266</u>	<u>5,175,840</u>	<u>21,412,897</u>
Total Costs Reported		<u>37,609,520</u>	<u>29,437,759</u>	<u>9,747,297</u>	<u>16,686,956</u>	<u>39,681,442</u>	<u>133,162,974</u>
Recommended Adjustments For:							
Direct Costs:							
Costs Funded by Other Federal Grants	NOTE 1	2,765,630	2,328,384	1,707,127	782,496	2,540,338	10,123,975
Unsupported (Unreported) Salaries	NOTE 1	329,568	155,497	(7,139,760)	3,109,944	1,830,533	(1,714,218)
Unsupported (Unreported) Supply and Other Costs	NOTES 1 & 6	<u>2,024,996</u>	<u>(921,008)</u>	<u>(77,202)</u>	<u>238,046</u>	<u>6,681,425</u>	<u>7,946,257</u>
Sub-total, Report Finding 1		5,120,194	1,562,873	(5,509,835)	4,130,486	11,052,296	16,356,014
Unsupported Fringe Benefit Rate - Report Finding 2	NOTE 2	1,129,644	949,218	305,880	521,602	1,173,362	4,079,706
Contracted Interpreters - Report Finding 3	NOTE 3	218,033	223,946	22,905	55,669	284,301	804,854
Unallocated Support Costs - Report Finding 4	NOTES 1 & 4	<u>151,146</u>	<u>147,258</u>	<u>148,314</u>	<u>32,955</u>	<u>172,029</u>	<u>651,702</u>
Sub-total, Direct costs		6,619,017	2,883,295	(5,032,736)	4,740,712	12,681,988	21,892,276
Indirect Costs:							
Use of Uncapped Indirect Cost Rate- Report Finding 5	NOTE 5	0	0	1,714,770	2,935,613	0	4,650,383
Indirect cost related to Direct Cost Findings (@ 15% of direct cost)		<u>992,853</u>	<u>432,496</u>	<u>(754,910)</u>	<u>711,106</u>	<u>1,902,298</u>	<u>3,283,841</u>
Sub-total, Indirect costs		<u>992,853</u>	<u>432,496</u>	<u>959,860</u>	<u>3,646,719</u>	<u>1,902,298</u>	<u>7,934,224</u>
Recommended Disallowances (Additions) to Reported Costs		<u>7,611,870</u>	<u>3,315,791</u>	<u>(4,072,876)</u>	<u>8,387,431</u>	<u>14,584,286</u>	<u>29,826,500</u>
Allowable Costs per Audit (Total reported by DPS, less adjustments)		<u>29,997,650</u>	<u>26,121,968</u>	<u>13,820,173</u>	<u>8,299,526</u>	<u>25,097,157</u>	<u>103,336,474</u>

NOTES applicable to this summary (Schedule B) and Schedules B1 to B5 are presented following Schedule B - 5.

RECOMMENDED ADJUSTMENTS TO COSTS CLAIMED FOR THE PERIOD JANUARY 1 THROUGH MARCH 31, 2004 (1st Quarter)

	<u>Notes</u>	<u>AOP Staff Salaries</u>	<u>Support Worker Salaries</u>	<u>Fringe Benefits</u>	<u>Contracted Services</u>	<u>Supplies and Other Costs</u>	<u>Total Direct Costs</u>	<u>Indirect Costs</u>	<u>Total Costs in 1st Quarter</u>
Costs Used in DPS Claim Calculations:		<u>\$18,973,879</u>	<u>\$1,791,646</u>	<u>\$8,721,520</u>	<u>\$2,934,693</u>	<u>\$282,192</u>	<u>\$32,703,930</u>	<u>\$4,905,590</u>	<u>\$37,609,520</u>
<u>Recommended Adjustments For:</u>									
Direct Costs :									
Costs Funded by Other Federal Grants	NOTE 1	\$2,025,212		\$740,418			\$2,765,630	\$414,844	\$3,180,474
Unsupported (Unreported) Salaries	NOTE 1	111,201	130,135	88,232			329,568	49,435	379,004
Unsupported (Unreported) Supply and Other Costs	NOTES 1 & 6				2,251,077	(226,081)	2,024,996	303,749	2,328,745
Unsupported Fringe Benefit Rate	NOTE 2			1,129,644			1,129,644	169,447	1,299,091
Contracted Interpreters	NOTE 3				218,033		218,033	32,705	250,738
Unallocated Support Costs	NOTES 1 & 4		70,720	25,855		54,571	151,146	22,672	173,818
Recommended Disallowances (Additions) to Reported Costs		<u>2,136,413</u>	<u>200,855</u>	<u>1,984,149</u>	<u>2,469,110</u>	<u>(171,510)</u>	<u>6,619,017</u>	<u>992,853</u>	<u>7,611,870</u>
Allowable Costs per Audit (DPS costs claimed, less adjustments)		<u>\$16,837,466</u>	<u>\$1,590,791</u>	<u>\$6,737,371</u>	<u>\$465,583</u>	<u>\$453,702</u>	<u>\$26,084,913</u>	<u>\$3,912,737</u>	<u>\$29,997,650</u>

RECOMMENDED ADJUSTMENTS TO COSTS CLAIMED FOR THE PERIOD APRIL 1 THROUGH JUNE 30, 2004 (2nd Quarter)

	<u>Notes</u>	<u>AOP Staff Salaries</u>	<u>Support Worker Salaries</u>	<u>Fringe Benefits</u>	<u>Contracted Services</u>	<u>Supplies and Other Costs</u>	<u>Total Direct Costs</u>	<u>Indirect Costs</u>	<u>Total Costs in 2nd Quarter</u>
Costs Used in DPS Claim Calculations:		<u>\$16,131,065</u>	<u>\$1,317,799</u>	<u>\$7,328,523</u>	<u>\$152,322</u>	<u>\$668,341</u>	<u>\$25,598,050</u>	<u>\$3,839,708</u>	<u>\$29,437,758</u>
<u>Recommended Adjustments For:</u>									
Costs Funded by Other Federal Grants	NOTE 1	\$1,705,026		\$623,358			\$2,328,384	\$349,258	\$2,677,641
Unsupported (Unreported) Salaries	NOTE 1	203,770	(89,903)	41,630			155,497	23,325	178,821
Unsupported (Unreported) Supply and Other Costs	NOTES 1& 6				(734,452)	(186,556)	(921,008)	(138,151)	(1,059,159)
Unsupported Fringe Benefit Rate	NOTE 2			949,218			949,218	142,383	1,091,601
Contracted Interpreters	NOTE 3				223,946		223,946	33,592	257,538
Unallocated Support Costs	NOTES 1& 4		40,818	14,923		91,517	147,258	22,089	169,347
Recommended Disallowances (Additions) to Reported Costs		<u>1,908,796</u>	<u>(49,085)</u>	<u>1,629,129</u>	<u>(510,506)</u>	<u>(95,039)</u>	<u>2,883,295</u>	<u>432,494</u>	<u>3,315,789</u>
Allowable Costs per Audit (DPS costs claimed, less adjustments)		<u>\$14,222,269</u>	<u>\$1,366,884</u>	<u>\$5,699,394</u>	<u>\$662,828</u>	<u>\$763,380</u>	<u>\$22,714,755</u>	<u>\$3,407,213</u>	<u>\$26,121,969</u>

RECOMMENDED ADJUSTMENTS TO COSTS CLAIMED FOR THE PERIOD JULY 1 THROUGH AUGUST 31, 2004 (Quarter 3A)

	<u>Notes</u>	<u>AOP Staff Salaries</u>	<u>Support Worker Salaries</u>	<u>Fringe Benefits</u>	<u>Contracted Services</u>	<u>Supplies and Other Costs</u>	<u>Total Direct Costs</u>	<u>Indirect Costs</u>	<u>Total Costs in Quarter 3A</u>
Costs Used in DPS Claim Calculations:		<u>\$4,321,222</u>	<u>\$546,395</u>	<u>\$2,040,212</u>	<u>\$33,573</u>	<u>\$43,404</u>	<u>\$6,984,806</u>	<u>\$2,762,491</u>	<u>\$9,747,297</u>
Recommended Adjustments For:									
Costs Funded by Other Federal Grants	NOTE 1	\$1,258,665		\$448,462			\$1,707,127	\$256,069	\$1,963,196
Unsupported (Unreported) Salaries	NOTE 1	(4,794,298)	(469,847)	(1,875,615)			(7,139,760)	(1,070,964)	(8,210,724)
Unsupported (Unreported) Supply and Other Costs	NOTES 1 & 6				(1,254)	(75,948)	(77,202)	(11,580)	(88,782)
Unsupported Fringe Benefit Rate	NOTE 2			305,880			305,880	45,882	351,762
Contracted Interpreters	NOTE 3				22,905		22,905	3,436	26,341
Unallocated Support Costs	NOTES 1 & 4		97,201	34,633		16,480	<u>148,314</u>	<u>22,247</u>	<u>170,561</u>
Sub-total, Direct Cost Adjustments		<u>(\$3,535,633)</u>	<u>(\$372,646)</u>	<u>(\$1,086,640)</u>	<u>\$21,651</u>	<u>(\$59,468)</u>	<u>(\$5,032,736)</u>	<u>(\$754,910)</u>	<u>(\$5,787,646)</u>
Use of uncapped indirect cost rate	NOTE 5							1,714,770	1,714,770
Recommended Disallowances (Additions) to Reported Costs		<u>(3,535,633)</u>	<u>(372,646)</u>	<u>(1,086,640)</u>	<u>21,651</u>	<u>(59,468)</u>	<u>(5,032,736)</u>	<u>959,860</u>	<u>(4,072,876)</u>
Allowable Costs per Audit (DPS costs claimed, less adjustments)		<u>\$7,856,855</u>	<u>\$919,041</u>	<u>\$3,126,852</u>	<u>\$11,922</u>	<u>\$102,872</u>	<u>\$12,017,542</u>	<u>\$1,802,631</u>	<u>\$13,820,173</u>

RECOMMENDED ADJUSTMENTS TO COSTS CLAIMED FOR THE PERIOD SEPTEMBER 1 THROUGH SEPTEMBER 30, 2004 (Quarter 3B)

	<u>Notes</u>	<u>AOP Staff Salaries</u>	<u>Support Worker Salaries</u>	<u>Fringe Benefits</u>	<u>Contracted Services</u>	<u>Supplies and Other Costs</u>	<u>Total Direct Costs</u>	<u>Indirect Costs</u>	<u>Total Costs in Quarter 3B</u>
Costs Used in DPS Claim Calculations:		<u>\$7,583,904</u>	<u>\$604,499</u>	<u>\$3,439,130</u>	<u>\$159,683</u>	<u>\$170,475</u>	<u>\$11,957,691</u>	<u>\$4,729,267</u>	<u>\$16,686,958</u>
<u>Recommended Adjustments For:</u>									
Costs Funded by Other Federal Grants	NOTE 1	\$576,934	\$	\$205,562	\$	\$	\$782,496	\$117,374	\$899,870
Unsupported (Unreported) Salaries	NOTE 1	2,137,950	155,012	816,982			3,109,944	466,492	3,576,436
Unsupported (Unreported) Supply and Other Costs	NOTES 1& 6				104,014	134,032	238,046	35,707	273,753
Unsupported Fringe Benefit Rate	NOTE 2			521,602			521,602	78,240	599,842
Contracted Interpreters	NOTE 3				55,669		55,669	8,350	64,019
Unallocated Support Costs	NOTES 1& 4		<u>21,451</u>	<u>7,643</u>		<u>3,861</u>	<u>32,955</u>	<u>4,943</u>	<u>37,898</u>
Sub-total, Direct Cost Adjustments		<u>\$2,714,884</u>	<u>\$176,463</u>	<u>\$1,551,789</u>	<u>\$159,683</u>	<u>\$137,893</u>	<u>\$4,740,712</u>	<u>\$711,107</u>	<u>\$5,451,819</u>
Use of uncapped indirect cost rate	NOTE 5							<u>2,935,613</u>	<u>2,935,613</u>
Recommended Disallowances (Additions) to Reported Costs		<u>2,714,884</u>	<u>176,463</u>	<u>1,551,789</u>	<u>159,683</u>	<u>137,893</u>	<u>4,740,712</u>	<u>3,646,720</u>	<u>8,387,432</u>
Allowable Costs per Audit (DPS costs claimed, less adjustments)		<u>\$4,869,020</u>	<u>\$428,036</u>	<u>\$1,887,341</u>	<u>\$0</u>	<u>\$32,582</u>	<u>\$7,216,979</u>	<u>\$1,082,547</u>	<u>\$8,299,526</u>

RECOMMENDED ADJUSTMENTS TO COSTS CLAIMED FOR THE PERIOD OCTOBER 1 THROUGH DECEMBER 31, 2004 (4th Quarter)

	<u>NOTES</u>	<u>AOP Staff Salaries</u>	<u>Support Worker Salaries</u>	<u>Fringe Benefits</u>	<u>Contracted Services</u>	<u>Supplies and Other Costs</u> NOTE 6	<u>Total Direct Costs</u>	<u>Indirect Costs</u>	<u>Total Costs in 4th Quarter</u>
Costs Used in DPS Claim Calculations:		<u>\$16,299,961</u>	<u>\$2,120,147</u>	<u>\$7,736,446</u>	<u>\$4,339,717</u>	<u>\$4,009,331</u>	<u>\$34,505,602</u>	<u>\$5,175,840</u>	<u>\$39,681,442</u>
<u>Recommended Adjustments For:</u>									
Costs Funded by Other Federal Grants	NOTE 1	\$1,872,991		\$667,347			\$2,540,338	\$381,051	\$2,921,388
Unsupported (Unreported) Salaries	NOTE 1	633,116	716,536	\$480,881			1,830,533	274,580	2,105,113
Unsupported (Unreported) Supply and Other Costs	NOTES 1 & 6				3,174,142	3,507,283	6,681,425	1,002,214	7,683,639
Unsupported Fringe Benefit Rate	NOTE 2			1,173,362			1,173,362	176,004	1,349,366
Contracted Interpreters	NOTE 3				284,301		284,301	42,645	326,946
Unallocated Support Costs	NOTES 1 & 4		82,584	29,425		60,020	172,029	25,804	197,833
Recommended Disallowances (Additions) to Reported Costs		<u>2,506,107</u>	<u>799,120</u>	<u>2,351,014</u>	<u>3,458,443</u>	<u>3,567,303</u>	<u>12,681,987</u>	<u>1,902,298</u>	<u>14,584,285</u>
Allowable Costs per Audit (DPS claim, less adjustments)		<u>\$13,793,854</u>	<u>\$1,321,027</u>	<u>\$5,385,432</u>	<u>\$881,274</u>	<u>\$442,028</u>	<u>\$21,823,615</u>	<u>\$3,273,542</u>	<u>\$25,097,157</u>

Order of Precedence in the Calculation of Adjustments

Our findings frequently overlap each other. For example, some fringe benefits are considered unallowable because they relate to unallowable salaries. But some of the same fringe benefits are also unallowable because they were calculated using a fringe benefit rate that was too high, and applied to the unallowable salaries. And some indirect cost claimed was based on the overstated benefits for unallowable salaries at an uncapped (and unallowable) indirect cost rate.

To avoid potential duplication(s) in our recommended adjustments, we adopted the following conventions:

- 1) Indirect costs claimed at a rate over the maximum allowable 15% of total direct cost are calculated assuming all direct cost claimed by DPS was allowable. Therefore, after adjusting for the use of uncapped indirect cost rates (NOTE 5), we tentatively allowed indirect costs equal to 15% of all direct costs claimed.
- 2) Excess fringe benefits claimed because the fringe benefit rate was too high (NOTE 2) are calculated using the salaries as claimed by DPS. Our adjustment includes both the unallowable fringe benefits and the indirect costs previously allowed at 15% of direct cost. After this adjustment, only the allowable fringe benefit costs (and allowable indirect costs) related to all salaries claimed are remaining.
- 3) Adjustments for unallowable, unreported or unallocated salaries include the related fringe benefits allowed in item 2) and 15% of the salary plus fringe benefits total for indirect costs allowed in item 1).
- 4) All other adjustments to the direct cost claimed include indirect costs at the 15% rate allowed in 1) above.

Notes to Schedule B

NOTE 1 : The net result of all adjustments recommended for costs funded by other Federal grants and the unsupported (unreported) costs is to adjust the amounts on the original DPS cost reports to the amounts of locally funded cost DPS could support in its accounting records. See Finding 1.

- For purposes of our report calculations we assumed that all **AOP staff salaries** supported by DPS had been included on cost reports and in claim calculations. The portion of the total salaries supported by DPS but funded by other Federal grants was disallowed first. The difference between the salaries claimed and the remaining, locally funded, salaries supported by DPS is included in the adjustments recommended for unsupported (unreported) salaries.

- The recommended adjustments for unsupported (unreported) salaries also includes the difference between the salaries claimed for **support workers** and the locally funded costs supported by DPS. The Federally funded portion of support costs is compared to the estimated cost of supporting the Federal programs on Schedule C. In general, the cost of supporting AOP staff employees' work for other programs was not entirely funded by those programs. The difference is the recommended adjustment reported for unallocated support costs.

NOTE 2 : DPS reported fringe benefits as 42% of salaries. We found this was based on an historical rate that had not been updated to reflect the actual cost of benefits during CY 2004. DPS recalculated the rate using CY 2004 data and found that rates of approximately 36% were more accurate. We are recommending the disallowance of fringe benefits claimed in excess of the actual CY 2004 rates determined by DPS. See Finding 2.

NOTE 3 : The cost of contract interpreters is a recommended disallowance because we could find no demonstrable benefit to Medicaid. During CY 2004, interpreters were allowed on the AOP staff list and subject to the RMTS. However, the RMTS results during CY 2004 indicated that interpreters performed very little AOP work and their inclusion reduced the allowable Medicaid percentage applied to all the AOP costs reported (Finding 3).

NOTE 4 : The new computer program devised by DPS reported that over 10% of the AOP staff salaries paid each claim period were funded by other Federal grants. We estimate the same percentages of the support staff time and the supplies used by employees on the staff list were used for those other Federal programs. Accordingly, we allocated the appropriate percentage of the support costs for each claim period to the other programs. Further details are in Finding 4 and our calculations are shown on Schedule C.

NOTE 5 : PCG provides a cost report template to each school district for each claim period. The template lists the names of each employee (staff position) from that district that was included in the RMTS, the district's indirect cost rate and the allocation percentages from the RMTS. Although schools had been advised to verify that the correct indirect cost rate was entered by PCG, DPS failed to do so. PCG supplied a 39.55% (uncapped) rate, although all school rates are capped at 15%, and DPS used the higher rate to calculate its Medicaid claim. See Finding 5.

NOTE 6 : DPS totals used for claim calculations did not include approximately \$281,000 of the costs listed on the QE December 2004 cost report. The formula used in the cost report to sum the listed costs did not include costs listed at the bottom of the page. The unclaimed costs reduce the adjustment amount recommended for Unsupported Supply and Other Costs.

ALLOCATION OF NON-PAYROLL AND SUPPORT WORKER COSTS TO THE FEDERAL PROGRAMS THEY SUPPORTED (see NOTE below)

	January 1 through March 31, 2004 (1st Quarter)	April 1 through June 30, 2004 (2nd Quarter)	July 1 through August 31, 2004 (Quarter 3A)	Sept. 1 through Sept. 30, 2004 (Quarter 3B)	October 1 through Dec. 31, 2004 (4th Quarter)	Calendar Year 2004 Totals
<u>Non - Payroll Cost Allocations:</u>						
Total non-payroll, direct costs identified by DPS	\$1,191,889	\$1,741,671	\$154,179	\$92,112	\$1,667,623	\$4,847,474
Less: Payments for contracted AOP staff positions	<u>(683,616)</u>	<u>(886,774)</u>	<u>(34,827)</u>	<u>(55,669)</u>	<u>(1,165,575)</u>	<u>(2,826,461)</u>
Supply & other (non-payroll) costs to support AOP staff	\$508,273	\$854,897	\$119,352	\$36,443	\$502,048	\$2,021,013
Percentage of staff work for other Federal grants	<u>10.74%</u>	<u>10.71%</u>	<u>13.81%</u>	<u>10.59%</u>	<u>11.96%</u>	
Estimated supplies used for other Federal grants	<u>\$54,571</u>	<u>\$91,517</u>	<u>\$16,480</u>	<u>\$3,861</u>	<u>\$60,020</u>	<u>\$226,450</u>
<u>Support Worker Salary Allocations:</u>						
Payroll costs for employees that support AOP staff:						
DPS re-calculation of claimed worker salaries	\$1,644,127	\$1,416,932	\$1,021,156	\$448,460	\$1,401,881	\$5,932,556
Additional salaries (not claimed due to Federal funding)	114,314	\$90,675	20,119	27,925	91,340	\$344,373
Omitted from DPS re-calculation, found in audit tests	<u>23,690</u>	<u>\$23,146</u>	<u>24,995</u>	<u>2,369</u>	<u>7,181</u>	<u>\$81,381</u>
Total cost to support AOP staff employees	\$1,782,131	\$1,530,753	\$1,066,270	\$478,754	\$1,500,402	\$6,358,310
Percentage of staff work for other Federal grants	<u>10.74%</u>	<u>10.71%</u>	<u>13.81%</u>	<u>10.59%</u>	<u>11.96%</u>	
Estimated cost to support AOP staff while they worked for other Federal programs	\$191,340	\$163,868	\$147,230	\$50,718	\$179,375	\$732,532
Support costs paid by the other Federal programs	<u>120,620</u>	<u>123,051</u>	<u>50,028</u>	<u>29,267</u>	<u>96,791</u>	<u>\$419,757</u>
Estimated salaries paid to support other Federal grants	<u>\$70,720</u>	<u>\$40,817</u>	<u>\$97,202</u>	<u>\$21,451</u>	<u>\$82,584</u>	<u>\$312,775</u>

NOTE: The fringe benefits related to disallowed salaries and the indirect cost related to all disallowed (direct) costs are added on Schedules B - 1 through B - 5.