

ALLOWABLE / UNALLOWABLE COST REFERENCE MANUAL

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Table of Contents

- 1. INTRODUCTION 3
- 2. BACKGROUND..... 3
- 3. COST REPORTING..... 4
- 4. PROVIDER INVOICING (SUD and MH) 4
- 5. APPLICABLE REGULATIONS 5
- 6. COST COMPOSITION OVERVIEW 5
- 7. COST CONSIDERATIONS 7
- 8. UNALLOWABLE COSTS..... 10
- 9. SUFFICIENT COST DATA..... 13
- 10. EXHIBIT 1 – REGULATORY RESOURCES 15
- 11. EXHIBIT 2 – DHCS AUDIT FINDINGS EXAMPLES 19

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Disclaimer: This manual was prepared as a service by the County of Fresno Department of Behavioral Health to all contracted service providers and is not intended to grant rights or impose obligations. This manual may contain references or links to statutes, regulations, or other policy materials. The information provided is only intended to be a general summary. It is not intended to take the place of either the written law or regulations. We encourage readers to review the specific statutes, regulations and other interpretive materials for a full and accurate statement of their content.

1. INTRODUCTION

Fresno County Department of Behavioral Health (DBH) contracted providers are compensated for services provided based on actual, allowable costs incurred. Some contracted providers are initially compensated monthly based on a negotiated rate. While others, are compensated on a monthly basis based on their actual costs recorded in their General Ledger (GL) each month. Regardless of the method of compensation, providers will be compensated for the cost of services provided up to the contract maximum. This resource manual is designed to be used as guidance by DBH contracted service providers, and the analysts that monitor them, in the determination of allowable costs.

2. BACKGROUND

This reference manual is intended to be a resource to providers to improve billing and cost claiming accuracy, reduce recoupments and improve audit outcomes.

Service providers contracted with DBH to provide services to Fresno County residents are required to report actual costs incurred on a monthly basis in the form of line-item invoicing with supporting documentation, and again annually in the form of cost report with supporting documentation. The monthly submissions allow the Contracts Division to monitor provider compliance with the financial regulations attached to funding sources. Whereas the annual cost report submission is a contractual requirement imposed by the State of California and the Federal government as a condition to receiving public funds.

SUBSTANCE USE DISORDER (SUD)

Drug Medi-Cal (DMC)

DMC providers are initially paid (reimbursed) for their services based upon rates set annually by the Department of Health Care Services (DHCS), or the provider's usual and customary charge (for the same service to the general public) – whichever is lower. The final reimbursement amount for DMC services rendered is the lower of the annual rate, the provider's usual or customary charge, or the provider's actual allowable costs. The actual allowable costs are determined during the DHCS settlement process, or after a DHCS or a Center for Medicare and Medicaid Services (CMS) audit. If the actual allowable costs are lower than what the provider was initially reimbursed for the services provided, the provider will incur a recoupment. This recoupment amount is the difference between what the provider was paid for the services it initially billed and its actual costs incurred to provide those services. DMC providers are not compensated for excess costs incurred that exceed the annual rate (or the provider's usual and customary charge – if lower) times the total Units of Services (UOS) provided during the fiscal year (FY). Federal regulations require that DMC providers submit annual cost reports verifiable by financial records and source documentation.

DMC Organized Delivery System (ODS) Waiver

When the DMC – ODS Waiver becomes effective for Fresno County contracted SUD providers will be initially compensated based on a contractually negotiated UOS rate. However, the DHCS settlement process will settle to the contractors' actual and allowable costs incurred to provide the ODS services not to exceed the maximum UOS rate negotiated with Fresno County.

Non-DMC

Non-DMC providers are initially compensated for SUD services provided at either a pre-negotiated rate or on a cost reimbursement basis. After the end of the FY, all non-DMC contracted providers are required to submit a cost report, including supporting documentation showing actual costs and total reimbursement received from Fresno County. Providers whose actual costs per unit of service exceed the pre-negotiated rate may receive a settlement, not to exceed contract maximum, depending on the funding source. Providers that incur total costs less than the pre-negotiated rate will be required to return the overpayment to Fresno County.

Please note that providers that deliver both DMC and non-DMC Outpatient Drug-Free (ODF) services, and proper cost allocation methodology is used, the actual costs incurred per unit will be identical for both the DMC and non-DMC services. Only those costs allocable to the non-DMC services in excess of what the provider was reimbursed for those services will be allowed. All excess costs greater than what was allowed for DMC services will not be absorbed by the non-DMC contract.

3. COST REPORTING

SUD

All DMC and non-DMC service providers, with the exception of Narcotic Treatment Providers (NTP), are contractually required to submit annual (fiscal year) cost reports that itemize their actual costs for the services provided. Only those actual costs that are allowed by applicable State and Federal regulations can be included in the cost report. For Federally funded contracts, cost must meet the criteria listed in 2 CFR [200.403](#) to be allowable.

4. PROVIDER INVOICING (SUD and MH)

In order to adequately monitor provider costs, the contracted providers must submit monthly line-item invoices along with documentation which supports those costs. The documentation shall be in the form of a General Ledger (GL) from the provider's accounting system along with certain corresponding source documentation (journals, invoices, receipts, etc.).

The DHCS has up to three years after the cost settlement process to conduct financial audits on selected providers. Providers will be required to submit to DHCS for review the following: (1) GL, (2) Cash Payments Journal, (3) Cash Receipts Journal, (4) General Journal, and (5) any source

documentation which the auditors request. Failure to produce those records could result in denial of services provided and substantial recoupment.

5. APPLICABLE REGULATIONS

To prevent recoupments, it is critically important that providers only charge (bill, allocate) to their contracts those costs which are allowed by the applicable regulations. If the provider incurs costs that are unallowable, then the provider cannot include them in their billing or cost reporting calculation. DBH wants to ensure that providers are keeping adequate and detailed financial records that comply with regulatory requirements which the County and its contracted providers are contractually required to monitor and control.

Federal

Code of Federal Regulations (CFR) Title 42 – Public Health governs federally funded health care services which includes Medicare and Substance Abuse Prevention and Treatment block grant (SABG) funded services. Providers that expend these funds must follow the applicable as well as overlapping regulations. Providers (sub-recipients) must follow the cost principles of CFR Title 2, Part 200 (2 CFR Part 200) – UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS, which is also known as the Super-Circular. Title 42, Public Health, Part 413 (42 CFR Part 413), *Principles of Reasonable Cost*, additionally covers DMC. While Title 45 – Public Welfare, Part 75 (45 CFR Part 75) *Cost Principles (Subpart E—Cost Principles)* additionally covers SABG funded services. The Cost Principles in Subpart E of 45 CFR Part 75 mirror those found within the Cost Principles of 2 CFR Part 200. The above regulations are promulgated from the United States Code (U.S.C.). The relevant U.S.C. law that is the foundation of allowable cost regulations is 42 USC §1395x (v), Reasonable Costs.

State

Behavioral Health Realignment funds are covered by regulations set forth in [Title 9](#) Rehabilitative and Developmental Services and [Title 22](#) Social Security of the California Code of Regulations (CCR), and in Sections [11750](#) and [11818](#) of Division 10.5 of the California Health and Safety Code (HSC). Further guidance for county providers that are reimbursed using appropriated state funds can be found in the State of California’s Auditing Standards and Procedures for Counties ([ASP](#)).

6. COST COMPOSITION OVERVIEW

Total Cost (TC) - is the sum of the direct cost (DC) and allocable indirect costs (IC) less any applicable credits (AC) ([§200.402](#))

$$TC = DC + IC - AC$$

Direct Costs ([§200.413](#)) - Direct costs are those costs that can be identified specifically with a particular final cost objective, such as a Federal award, or other internally or externally funded

activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. The following are examples of direct costs:

- The labor to provide direct services by a Drug Counselor to the SUD client (e.g. group therapy, and individual counseling/therapy).
- The cost paid to the Department of Healthcare Services to obtain DMC site certification.

Indirect (facilities & administrative (F&A)) costs (§200.56) - Indirect (F&A) costs means those costs incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect (F&A) costs. Indirect (F&A) cost pools must be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived. See also (§200.414). The following are examples of indirect costs:

- The rent paid on the facility used to provide services to clients under multiple contracts such as DMC and SABG.
- The salaries and benefits of the Program Manager.

Substance Abuse Prevention Treatment Block Grant (SABG) funded services specific rule on indirect costs:

Provider corporate overhead costs applied to SABG funded contracts cannot exceed 25% of the program's total cost. For example, a provider has a Federally approved indirect cost rate of 28%. A program (e.g. Outpatient) has a total program cost of \$100,000. Corporate overhead of \$28,000 ($\$100,000 \times 28\%$) is allocated to this program. However, of the \$100,000 of direct program costs 80% is for DMC funded services and 20% is for Non-DMC (SABG) funded services. The SABG portion of the \$28,000 in overhead is \$5,600 ($\$28,000 \times 20\%$) without the above restriction and \$5,000 ($\$25,000 \times 25\%$) with the above restriction. Therefore only \$5,000 of the SABG indirect costs is allowed and \$600 is unallowable. Please note that this restriction does not apply to DMC-funded services. The allocated portion of the DMC indirect is still \$22,400 ($\$28,000 \times 80\%$). Please see DHCS BH Information Notice [20-021](#) (3)(d) on page 3.

Applicable Credits (§200.406) (a) Applicable credits refer to those receipts or reduction-of-expenditure-type transactions that offset or reduce expense items allocable to the Federal award as direct or indirect (F&A) costs. To the extent that such credits accruing to or received by the non-Federal entity relate to allowable costs, they must be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges.

7. COST CONSIDERATIONS

Prior to incurring a cost under a County funded contract, providers must determine whether the cost is allowable or unallowable. The following sections will provide further guidance to assist providers with making these determinations. Regardless of funding source, State, Federal, or local, providers must consistently apply these guidelines.

Allowable Costs

Costs cannot be billed to contracts funded with Federal dollars unless they are determined to be allowable, reasonable, and allocable. This section will define how costs are determined to meet this criterion. Costs are reimbursable under Federal awards (DMC and SABG) if they are **allowable** (§200.403), **reasonable** (§200.404), and **allocable** (§200.405).

Salary Restriction applied to SABG (non-DMC) funded services:

As noted in the SABG Policy [Manual](#), Section 3 on page 4, SUD providers are restricted to the [Level II](#) Executive Salary Cap when applied to SABG funded services. For explanation on how this rule is applied please contact the DBH Fiscal Analyst.

Factors Affecting the Allowability of Costs (§200.403)

Except where otherwise authorized by statute, costs must meet the following general criteria in order to be **allowable** under Federal awards:

- a) Be necessary and reasonable for the performance of the Federal award and be allocable thereto under these principles.
- b) Conform to any limitations or exclusions set forth in these principles or in the Federal award as to types or amount of cost items.
- c) Be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity.
- d) Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.
- e) Be determined in accordance with generally accepted accounting principles (GAAP).
- f) Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.
- g) Be adequately documented.

Reasonable Costs (§200.404)

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when the non-Federal entity is predominantly federally-funded. In determining reasonableness of a given cost, consideration must be given to:

- a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the non-Federal entity or the proper and efficient performance of the Federal award.
- b) The restraints or requirements imposed by such factors as: sound business practices; arm's-length bargaining; Federal, state, local, tribal, and other laws and regulations; and terms and conditions of the Federal award.
- c) Market prices for comparable goods or services for the geographic area.
- d) Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the non-Federal entity, its employees, where applicable its students or membership, the public at large, and the Federal Government.
- e) Whether the non-Federal entity significantly deviates from its established practices and policies regarding the incurrence of costs, which may unjustifiably increase the Federal award's cost.

CFR Title 42 Public Health, Part 413, Section [§413.9](#), Cost Related to Patient Care (Reasonable Costs).

- a) **Principle.** All payments to providers of services must be based on the reasonable cost of services covered under Medicare and related to the care of beneficiaries. Reasonable cost includes all necessary and proper costs incurred in furnishing the services, subject to principles relating to specific items of revenue and cost. However, for cost reporting periods beginning after December 31, 1973, payments to providers of services are based on the lesser of the reasonable cost of services covered under Medicare and furnished to program beneficiaries or the customary charges to the general public for such services, as provided for in §413.13.
- b) **Definitions—**
 - 1) **Reasonable cost.** Reasonable cost of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included. The regulations in this part take into account both direct and indirect costs of providers of services. The objective is that under the methods of determining costs, the costs with respect to individuals covered by the program will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by the program. These regulations also provide for the making of suitable retroactive adjustments after the provider has submitted fiscal and statistical reports. The retroactive adjustment will represent the difference between the amount received by the provider during the year for covered services from both Medicare and the beneficiaries and the amount determined in accordance with an accepted method of cost apportionment to be the actual cost of services furnished to beneficiaries during the year.
 - 2) **Necessary and proper costs.** Necessary and proper costs are costs that are appropriate and helpful in developing and maintaining the operation of patient care facilities and activities. These are usually costs that are common and accepted occurrences in the field of the provider's activity.

Allocable Costs (§200.405)

- a) A cost is allocable to a particular Federal award or other cost objective if the goods or services involved are chargeable or assignable to that Federal award or cost objective in accordance with relative benefits received. This standard is met if the cost:
 - 1) Is incurred specifically for the Federal award;
 - 2) Benefits both the Federal award and other work of the non-Federal entity and can be distributed in proportions that may be approximated using reasonable methods; and
 - 3) Is necessary to the overall operation of the non-Federal entity and is assignable in part to the Federal award in accordance with the principles in this subpart.
- b) All activities which benefit from the non-Federal entity's indirect (F&A) cost, including unallowable activities and donated services by the non-Federal entity or third parties, will receive an appropriate allocation of indirect costs.
- c) Any cost allocable to a particular Federal award under the principles provided for in this part may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by Federal statutes, regulations, or terms and conditions of the Federal awards, or for other reasons. However, this prohibition would not preclude the non-Federal entity from shifting costs that are allowable under two or more Federal awards in accordance with existing Federal statutes, regulations, or the terms and conditions of the Federal awards.
- d) Direct cost allocation principles. If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then, notwithstanding paragraph (c) of this section, the costs may be allocated or transferred to benefitted projects on any reasonable documented basis. Where the purchase of equipment or other capital asset is specifically authorized under a Federal award, the costs are assignable to the Federal award regardless of the use that may be made of the equipment or other capital asset involved when no longer needed for the purpose for which it was originally required. See also §§200.310 Insurance coverage through 200.316 Property trust relationship and 200.439 Equipment and other capital expenditures.
- e) If the contract is subject to Cost Accounting Standards (CAS), costs must be allocated to the contract pursuant to the CAS. To the extent that CAS is applicable, the allocation of costs in accordance with CAS takes precedence over the allocation provisions in this part.

Allowable Cost Allocation Methodologies

Allocation of Facilities and Administration (F&A) indirect costs – The allocation of non-directly-traceable indirect costs to multiple cost centers (e.g. Residential, Intensive Out Patient (IOT), Outpatient, etc.) must follow [2 CFR Part 200 Appendix IV Indirect \(F&A\) Costs Identification and Assignment, and Rate Determination for Nonprofit Organization](#). Those organizations that contract directly with the Federal Government must use their Federally-approved indirect cost rate. Otherwise, providers are required by DHCS to use the

Percentage of Direct Cost indirect cost allocation methodology when allocating F&A costs to cost centers. If a provider wants to use a cost allocation methodology other than Percentage of Direct Cost, it must first submit a detailed cost allocation methodology proposal to DBH for approval. If DBH approves of this requested methodology, it will then submit the provider proposed methodology to DHCS for final approval.

Allocation of costs between programs (e.g. Residential, Outpatient, Intensive Outpatient, etc.) – The DHCS Excel DMC cost report template employs the Percentage of Direct costs indirect cost allocation methodology to distribute costs between programs.

8. UNALLOWABLE COSTS

Costs are **unallowable** if they are identified by the following:

- Specifically identified in the grant/contract as being unallowable.
- Specifically identified in the Center for Medicare and Medicaid Studies (CMS) Provider Reimbursement Manual (PRM) as being unallowable.
- Specifically identified in the Code of Federal Regulations (CFR) Title 2, Part 200 – Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards as being unallowable (applies to Non-profit organizations).
- Specifically identified in the Code of Federal Regulations (CFR) Title 45, Part 75 – 420.
- Specifically identified in Code of Federal Regulations (CFR) Title 48, Part 31.2 – Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards as being unallowable (applies to For-profit organizations).
- Not supported by source documentation.

Most Common Unallowable Costs:

1. **Public relations and advertising costs:** The only allowable public relations and advertising costs are ones that are “specifically required by the contract or that arise from requirements of Government Contracts.”
2. **Bad debts:** Including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs, and legal costs are unallowable.
3. **Contingencies:** Possible future events or conditions that result in increased costs are unallowable.
4. **Contributions or donations:** Including cash, property and services, regardless of recipient, are unallowable, except as provided in 31.205-1(e)(3).
5. **Cost of money:** Actual interest cost in lieu of the calculated imputed cost of money is unallowable.
6. **Depreciation costs:** That would significantly reduce the book value of a tangible capital asset below its residual value.

7. **Employee Morale, Health, Welfare, Dormitory and Foodservice:** Gifts, recreation except for the costs of employees' participation in company sponsored sports teams or employee organizations design to improve loyalty, teamwork or fitness.
8. **Costs of amusements, diversions, social activities [Entertainment]:** Or any directly associated costs such as tickets to show or events, or meals and transportation to such events are unallowable.
9. **Costs of Fines and Penalties:** From failure to comply with federal, state or local laws and regulations.
10. **Labor Relations costs:** Incurred costs from maintaining satisfactory labor relations between contractor and employees.
11. **Lobbying and Political Activity:** Costs associated with lobbying, influencing or supporting any political party or activity are unallowable.
12. **Losses on other Contracts:** An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) is unallowable.
13. **Organization Costs:** With the exception of activities intended to provide compensation for employees, all organizational expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, (2) resisting or planning to resist the reorganization of the corporate structure of a business or a change in the controlling interest in the ownership of a business, and (3) raising capital (net worth plus long-term liabilities), are unallowable.
14. **Patent Costs:** Preparation of invention disclosures and filing of a US Patent are all unallowable costs.
15. **Pre-Contract Costs:** Costs incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. These costs are allowable to the extent that they would have been allowable if incurred after the date of the contract.
16. **Recruitment Costs:** Help wanted/recruitment advertising are unallowable if they do not describe specific positions in detail, or if they include material that is not relevant to recruitment purposes, such as advertising/product descriptions.
17. **Relocation Costs:** Costs such as the loss on the sale of one's home, realtor's fees or commissions, and/or insurance costs are unallowable. For a more specific list, see Federal Acquisition Regulations (FAR) Section [31.205-35 \(C\)](#).
18. **Termination Costs:** Any costs continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.
19. **Costs related to Legal and Other Proceedings:** Costs incurred in connection with any proceeding brought by a Federal, State, local, or foreign government for violation of, or a failure to comply with, laws or regulations by the contractor (including its agents or employees), or costs incurred in connection with any proceeding brought by a third

party in the name of the United States under the False Claims Act, which result in a criminal or civil proceeding, or a conviction, are unallowable.

20. **Goodwill:** Any costs for amortization, expensing, write-off, or write-down of goodwill (however represented) are unallowable.
21. **Executive Lobbying Costs:** Costs incurred in attempting to improperly influence (see FAR 3.401), either directly or indirectly, an employee or officer of the executive branch of the Federal Government to give consideration or to act regarding a regulatory or contract matter are unallowable.
22. **Alcoholic Beverages.**

While the above list is an interpretation of the regulations regarding disallowed cost, the below U.S.C. section is the law upon which all unallowable costs specified in CFR are based.

USC Title 41 Public Contracts, Section 4304 Specific Costs not Allowable:

1. Costs of entertainment, including amusement, diversion, and social activities, and any costs directly associated with those costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities).
2. Costs incurred to influence (directly or indirectly) legislative action on any matter pending before Congress, a State legislature, or a legislative body of a political subdivision of a State.
3. Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of any false certification) brought by the Federal Government where the contractor is found liable or had pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification).
4. Payments of fines and penalties resulting from violations of, or failure to comply with, Federal, State, local, or foreign laws and regulations, except when incurred as a result of compliance with specific terms and conditions of the contract or specific written instructions from the contracting officer authorizing in advance those payments in accordance with applicable provisions of the Federal Acquisition Regulation.
5. Costs of membership in any social, dining, or country club or organization.
6. Costs of alcoholic beverages.
7. Contributions or donations, regardless of the recipient.
8. Costs of advertising designed to promote the contractor or its products.
9. Costs of promotional items and memorabilia, including models, gifts, and souvenirs.
10. Costs for travel by commercial aircraft that exceed the amount of the standard commercial fare.
11. Costs incurred in making any payment (commonly known as a "golden parachute payment") that is-
 - A. in an amount in excess of the normal severance pay paid by the contractor to an employee on termination of employment; and
 - B. paid to the employee contingent on, and following, a change in management control over, or ownership of, the contractor or a substantial portion of the contractor's assets
12. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship.
13. Costs of severance pay paid by the contractor to foreign nationals employed by the contractor under a service contract performed outside the United States, to the extent that the amount of severance pay paid in any case exceeds the amount paid in the

industry involved under the customary or prevailing practice for firms in that industry providing similar services in the United States, as determined under the Federal Acquisition Regulation.

14. Costs of severance pay paid by the contractor to a foreign national employed by the contractor under a service contract performed in a foreign country if the termination of the employment of the foreign national is the result of the closing of, or the curtailment of activities at, a Federal Government facility in that country at the request of the government of that country.
15. Costs incurred by a contractor or subcontractor, or personal service contractor in connection with any criminal, civil, or administrative proceeding commenced by the Federal Government or a State, to the extent provided in section 4310 of this title. ¹
16. Costs of compensation of any contractor employee for a fiscal year, regardless of the contract funding source, to the extent that such compensation exceeds \$625,000 adjusted annually for the U.S. Bureau of Labor Statistics Employment Cost Index for total compensation for private industry workers, by occupational and industry group not seasonally adjusted, except that the executive agency may establish exceptions for positions in the science, technology, engineering, mathematics, medical, and cybersecurity fields and other fields requiring unique areas of expertise upon a determination that such exceptions are needed to ensure that the executive agency has continued access to needed skills and capabilities. ²
17. Costs of compensation of contractor and subcontractor employees for a fiscal year, regardless of the contract funding source, to the extent that such compensation exceeds \$487,000 per year, adjusted annually to reflect the change in the Employment Cost Index for all workers, as calculated by the Bureau of Labor Statistics, except that the head of an executive agency may establish one or more narrowly targeted exceptions for scientists, engineers, or other specialists upon a determination that such exceptions are needed to ensure that the executive agency has continued access to needed skills and capabilities. ²

USC Title 41 Section 4305 is the law that requires regulations be promulgated by the various Federal Agencies on the allowability of costs prescribed in 4304 above. The resulting regulations in *General Provisions for Selected Items of Cost* in the Uniform Guidance regulations 2 CFR 200 (which covers Title 42), and in Title 45 offer comprehensive lists of costs and their proper treatment which does include exceptions to USC Title 41, Section 4304. Providers are encouraged to drill down into the regulation to determine if the particular cost in question is allowed.

9. SUFFICIENT COST DATA

The following is an excerpt from the Center for Medicare and Medicaid Studies (CMS) Provider Reimbursement Manual and 42 CFR Part 413. Adequate cost information must be obtained from the provider's records to support payments made for services furnished to beneficiaries. The requirement of adequacy of data implies that the **data be accurate and in sufficient detail** to accomplish the purposes for which it is intended. Adequate data capable of being audited is consistent with good business concepts and effective and efficient management of any organization, **whether it is operated for profit or on a nonprofit basis**. It is a reasonable expectation on the part of any agency paying for services on a cost-reimbursement basis (PRM Ch. 23, Section 2304).

CMS Provider Reimbursement Manual

Cost information as developed by the provider must be current, accurate, and in sufficient detail to support payments made for services rendered to beneficiaries. This includes all ledgers, books, records and original evidences of cost (purchase requisitions, purchase orders, vouchers, requisitions for materials, inventories, labor time cards, payrolls, bases for apportioning costs, etc.), which pertain to the determination of reasonable cost, capable of being audited.

Section 2304.1 Availability of Records of Providers – A participating provider of services must make available to its intermediary its fiscal and other records for the purpose of determining its ongoing record keeping capability. The intermediary's examination of such records and documents are necessary to ascertain information pertinent to the determination of the proper amount of program payments due the provider (See §2404ff.).

CFR TITLE 42 Public Health, Part 413 – Principles of Reasonable Cost Reimbursement

Section 413.24 (c) Adequacy of cost information

In order to provide the required cost data and not impair comparability, financial and statistical records should be maintained in a manner consistent from one period to another. However, a proper regard for consistency need not preclude a desirable change in accounting procedures if there is reason to effect such change.

10. EXHIBIT 1 – REGULATORY RESOURCES

This Exhibit includes links to the Provider Reimbursement Manual – Part I and relevant CFRs. The information provided herein is subject to change. Providers are responsible for verifying the status of this information.

CMS Publication #15-1: The Provider Reimbursement Manual - Part 1

Chapter 1 -- Depreciation

Chapter 2 -- Interest Expense

Chapter 3 -- Bad Debts, Charity, and Courtesy Allowances

Chapter 4 -- Cost of Educational Activities

Chapter 5 -- Research Costs

Chapter 6 -- Grants, Gifts and Income from Endowments

Chapter 7 -- Value of Services of Nonpaid Workers

Chapter 8 -- Purchase Discounts and Allowances, and Refunds

Chapter 9 - Compensation of Owners

Chapter 10 - Cost to Related Organizations

Chapter 11 - Allowance In Lieu Of Specific Recognition of Other Costs - RESERVED

Chapter 12 - Return On Equity Capital of Proprietary Providers - RESERVED

Chapter 13 - Inpatient Routine Nursing Salary Cost Differential - RESERVED

Chapter 14 - Reasonable Cost of Therapy and Other Services

Chapter 15 - Change of Ownership

Chapter 21 - Costs Related to Patient Care

Chapter 22 - Determination of Cost of Services

Chapter 23 - Adequate Cost Data and Cost Finding

Chapter 24 - Payment to Providers

Chapter 25 - Limitations on Coverage of Costs Under

Chapter 26 - Lower of Cost or Charges

Chapter 27 - ESRD Services and Supplies

Chapter 28 - Prospective Payments

Chapter 29 - Provider Payment Determination and Appeals

Chapter 30 - NON-PPS Hospitals and Distinct Part Units

2 CFR, PART 200 -GENERAL PROVISIONS FOR SELECTED ITEMS OF COST

§200.420 Considerations for selected items of cost

- §200.421 Advertising and public relations**
- §200.422 Advisory councils**
- §200.423 Alcoholic beverages**
- §200.424 Alumni/ae activities**
- §200.425 Audit services**
- §200.426 Bad debts**
- §200.427 Bonding costs**
- §200.428 Collections of improper payments**
- §200.429 Commencement and convocation costs**
- §200.430 Compensation—personal services**
- §200.431 Compensation—fringe benefits.**
- §200.432 Conferences**
- §200.433 Contingency provisions**
- §200.434 Contributions and donations**
- §200.435 Defense and prosecution of criminal and civil proceedings, claims, appeals and patent infringements**
- §200.436 Depreciation**
- §200.437 Employee health and welfare costs**
- §200.438 Entertainment costs**
- §200.439 Equipment and other capital expenditures**
- §200.440 Exchange rates**
- §200.441 Fines, penalties, damages and other settlements**
- §200.442 Fund raising and investment management costs**
- §200.443 Gains and losses on disposition of depreciable assets**
- §200.444 General costs of government**
- §200.445 Goods or services for personal use**
- §200.446 Idle facilities and idle capacity**
- §200.447 Insurance and indemnification**
- §200.448 Intellectual property**
- §200.449 Interest**
- §200.450 Lobbying**
- §200.451 Losses on other awards or contracts**
- §200.452 Maintenance and repair costs**
- §200.453 Materials and supplies costs, including costs of computing devices**
- §200.454 Memberships, subscriptions, and professional activity costs**
- §200.455 Organization costs**

- §200.456 Participant support costs
- §200.457 Plant and security costs
- §200.458 Pre-award costs
- §200.459 Professional service costs
- §200.460 Proposal costs.
- §200.461 Publication and printing costs
- §200.462 Rearrangement and reconversion costs
- §200.463 Recruiting costs
- §200.464 Relocation costs of employees
- §200.465 Rental costs of real property and equipment
- §200.466 Scholarships and student aid costs
- §200.467 Selling and marketing costs
- §200.468 Specialized service facilities
- §200.469 Student activity costs
- §200.470 Taxes (including Value Added Tax)
- §200.471 Termination costs
- §200.472 Training and education costs
- §200.473 Transportation costs
- §200.474 Travel costs
- §200.475 Trustees

45 CFR PART 75, SUBPART E – COST PRINCIPLES - GENERAL PROVISIONS FOR SELECTED ITEMS OF COST

- §75.420 Considerations for selected items of cost
- §75.421 Advertising and public relations
- §75.422 Advisory councils
- §75.423 Alcoholic beverages
- §75.424 Alumni/ae activities
- §75.425 Audit services
- §75.426 Bad debts
- §75.427 Bonding costs
- §75.428 Collections of improper payments
- §75.429 Commencement and convocation costs
- §75.430 Compensation—personal services
- §75.431 Compensation—fringe benefits
- §75.432 Conferences
- §75.433 Contingency provisions
- §75.434 Contributions and donations
- §75.435 Defense and prosecution of criminal and civil proceedings, claims, appeals, and patent infringements
- §75.436 Depreciation
- §75.437 Employee health and welfare costs

§75.438 Entertainment costs
§75.439 Equipment and other capital expenditures
§75.440 Exchange rates
§75.441 Fines, penalties, damages and other settlements
§75.442 Fund raising and investment management costs
§75.443 Gains and losses on disposition of depreciable assets
§75.444 General costs of government
§75.445 Goods or services for personal use
§75.446 Idle facilities and idle capacity
§75.447 Insurance and indemnification
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11. EXHIBIT 2 – DHCS AUDIT FINDINGS EXAMPLES

FINANCIAL FINDINGS AND RECOMMENDATIONS

DHCS selects a sampling of providers each year to conduct financial audits. Any findings identified during the course of an audit are subject to recoupment. This exhibit includes examples of audit findings and DHCS' recommended or required corrective actions.

Unallowable Operating Expenses

After conducting a review of the provider's general ledger, DHCS auditor found that provider charged **unallowable** operating expenses. These expenses were reported on the Contractor's cost report. Below is a list of the types of expenses that were found to be unallowable and why:

1. **Client Expense** – This expense was used to purchase gifts for client graduation.

Provider Reimbursement Manual (PRM), CMS [15-1](#), Section 2105.7, states:

“Costs incurred by providers for gifts or donations to charitable, civic, educational, medical or political entities are not allowable.”

2. **Penalties and Interest**- Credit card late fees and interest.

PRM, CMS 15-1, Section 2105.10, states:

"Costs incurred by providers for fines or monetary penalties imposed for violations of Federal, State, or local laws are not allowable."

3. **Finance Charges** - Interest expense on City tax.

PRM, CMS [15-1](#), Section 2105.10, states:

"Costs incurred by providers for fines or monetary penalties imposed for violations of Federal, State, or local laws are not allowable."

4. **Interest Expense Other**- This expense was part of the Franchise Tax Board penalty.

PRM, CMS 15-1, Section 2105.10, states:

"Costs incurred by providers for fines or monetary penalties imposed for violations of Federal, State, or local laws are not allowable."

5. **Business Promotions** - This expense was for a fund raiser event. This expense is unrelated to patient/client care and should not be charged to Drug Medi-Cal.

PRM, CMS-Pub. [15-1](#), Section 2136.2 states in part:

"Costs of fund-raising, including advertising, promotional, or publicity costs incurred for

such a purpose, are not allowable."

6. **Bank Service Charges** - This expense was from a bank overdraft fees and insufficient funds fee.

Provider Reimbursement Manual, CMS [15-1](#), Section 2102.3, states in part:

"Costs not related to patient care are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities and activities. Cost which are not necessary include costs which usually are not common or accepted occurrences in the field of the provider's activity."

7. **Non-DMC Patient Related Food Purchases** - Contractor made an unreasonable amount of food purchases for meetings and staff meals multiple times per week and reported it on the cost report. Food costs are not related to DMC client care and affects the cost per unit and reimbursement to both Contractor and County.

The Provider Reimbursement Manual, CMS- Pub. [15-1](#), Section 2105.2, states in part:

"The Cost of meals for other than provider personnel, whether served in a cafeteria, coffee shop, canteen, etc., is unallowable under the program because it is not related to patient care."

Inadequacy of Records

1. **The contractor did not have an adequate system of accounting in place to support the cost report.** Not having an adequate system of accounting can result in a misstatement of costs report. A misstatement of costs affects the rate per unit and reimbursement for both the contractor and the County.

42 CFR Section 413.20(a) states in part:

"The principles of cost reimbursement will require that providers maintain sufficient financial records and statistical data for proper determination of costs under the Program. [Drug-Medical]"

2. **Travel expense reported did not have supporting documentation.**

Contractor made purchases for personal automobile expenses and claimed the costs on the cost report without any supporting documentation verifying the need for DMC related client care. Not having supporting documentation such as itinerary and receipts for travel makes it difficult for the Auditor to determine if the travel expenses are related to DMC client care.

42 CFR Section 413.9 states in part:

"(a) Principle. - All payments to providers of services must be based on reasonable cost of services covered under Medicare and related to the care of beneficiaries. Reasonable cost includes all necessary and proper costs incurred in furnishing the services, subject to

principles relating to specific items of revenue and cost. However, for cost reporting periods beginning after December 31, 1973, payments to providers of services are based on the lesser of the reasonable cost of services covered under Medicare and furnished to program beneficiaries or the customary charges to the general public for such services, as provided for in §413.13."

The Provider Reimbursement Manual, CMS-Pub. 15-1, §2105.6 states in part:

"Employee Travel -- Costs incurred by providers in conjunction with employee travel are generally allowable to the extent that they are patient care related and reasonable. However, travel costs incurred in conjunction with non-patient care related employee travel are not allowable."

The Provider Reimbursement Manual, CMS- Pub. 15-1, 2102.3 states in part:

"Costs Not Related to Patient Care. - Costs not related to patient care are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities and activities. Costs which are not necessary include costs which usually are not common or accepted occurrences in the field of the provider's activity.

Such costs are not allowable in computing reimbursable costs and include, for example: Costs of travel incurred in connection with non-patient care related purposes."

The Provider Reimbursement Manual, CMS- Pub. 15-1, Section 2105.9 states in part:

"Costs incurred by providers related to the personal use of provider vehicles are not allowable."

Costs Not Related to Patient Care

CMS, Pub 15-1, Section 2102.3, states:

"Costs not related to patient care are costs which are not appropriate or necessary and proper in developing and maintaining the operation of patient care facilities and activities. Costs which are not necessary include costs which usually are not common or accepted occurrences in the field of the provider's activity. Such costs are not allowable in computing reimbursable costs and include, for example:

- Cost of meals sold to visitors;
- Cost of drugs sold to other than patients;
- Cost of operation of a gift shop;
- Cost of alcoholic beverages furnished to employees or to others regardless of how or where furnished, such as cost of alcoholic beverages furnished at a provider picnic or furnished as a fringe benefit;
- Cost of gifts or donations;
- Cost of entertainment, including tickets to sporting and other entertainment events;
- Cost of personal use of motor vehicles;
- Cost of fines or penalties resulting from violations of Federal, State, or local laws;
- Cost of educational expenses for spouses or other dependents of providers of services, their employees or contractors, if they are not active employees of the provider or contractor;

- Cost of meals served to executives that exceed the cost of meals served to ordinary employees due to the use of separate executive dining facilities (capital and capital-related costs), duplicative or additional food service staff (chef, waiters/waitresses, etc.), upgraded or gourmet menus, etc.; and
- Cost of travel incurred in connection with non-patient care related purposes.”

Method of Accounting and Accounting Record Requirements

Code of Federal Regulations, Title 42, Section 413.24(a), states in part:

“Principle. Providers receiving payment on the basis of reimbursable cost must provide adequate cost data. This must be based on their financial and statistical records which must be capable of verification by qualified auditors. The cost data must be based on an approved method of cost finding and on the **accrual basis of accounting**...”

Centers for Medicare & Medicaid Services (CMS), Pub 15-1, Section 2300, states:

“Providers receiving payment on the basis of reimbursable cost must provide adequate cost data based on financial and statistical records which can be verified by qualified auditors. The cost data must be based on an approved method of cost finding and on the **accrual basis of accounting**. However, where governmental institutions operate on a cash basis of accounting, cost data on this basis will be acceptable subject to appropriate treatment of capital expenditures.”

California Code of Regulations, Title 22, Section 51476(b), states:

“Records of institutional providers shall include, in addition, the following:

- (1) Records of receipts and disbursements of personal funds of beneficiaries being held in trust by the provider.
- (2) Employment records including shifts, schedules and payroll records of employees.
- (3) Book records of receipts and disbursements by the provider.
- (4) Individual ledger accounts reflecting credit and debit balances for each beneficiary to whom services are provided.”

CMS, Pub 15-1, Section 2304, states:

“Cost information as developed by the provider must be current, accurate, and in sufficient detail to support payments made for services rendered to beneficiaries. This includes all ledgers, books, records and original evidences of cost (purchase requisitions, purchase orders, vouchers, requisitions for materials, inventories, labor time cards, payrolls, bases for apportioning costs, etc.), which pertain to the determination of reasonable cost, capable of being audited.

Financial and statistical records should be maintained in a consistent manner from one period to another. However, a proper regard for consistency need not preclude a desirable change in accounting procedures, provided that full disclosure of significant change is made to the intermediary.”

Please note: Bank statements alone will be considered as insufficient support documentation by DHCS auditors and the charges will be disallowed and subject to recoupment.