HOBBS
STRAUS
DEAN &
WALKER

806 SW Broadway, Suite 900
Portland, OR 97205

T 503.242.1745
F 503.242.1072

HOBBSSTRAUS.COM

MEMORANDUM

February 3, 2016

TO: Contract Support Cost Clients

FROM: HOBBS, STRAUS, DEAN & WALKER, LLP Geoff Strommer By: NAM

RE: ***IHS CSC Workgroup Meeting Yields Further Progress on Policy***

The Indian Health Service (IHS) Contract Support Cost (CSC) Workgroup continues to push toward completion of a new CSC policy. In a one-day meeting in Washington, DC on January 29, 2016, the Workgroup traded proposals on the two major issues separating the agency and tribes: duplication and "costs incurred." Despite fundamental differences on both issues, the two sides made painful progress towards the goal of rolling out a new draft policy for tribal consultation later this month.

Duplication

IHS believes that most, if not all, previous calculations of CSC needs have not fully accounted for CSC-type costs included in the Secretarial or 106(a)(1) amount. In the case of Headquarters and Area Office tribal shares, this "duplication" is addressed by applying the 80/20 rule: 80% of the funding is deemed to be direct costs, and 20% indirect costs applied as a set-off to the indirect CSC need. Alternatively, a tribe can opt for an in-depth individual analysis of its funding to arrive at a different percentage (but according to IHS no tribe has ever done so).

IHS now wants to extend a similar non-duplication analysis to the much larger category of service unit funding—the lion's share of the 106(a)(1) amount. IHS conducted a study to determine the percentage of funding duplicative of CSC, but declined to share the results with the Workgroup, recognizing that it was too high for tribes to accept. At the previous meeting, tribes presented their own proposal: Duplication would be determined, at the tribe's option, through one of two alternatives: (A) an in-depth, case-by-case analysis; or (B) a default 97/3 rule, in which 97% of service-unit funding would be considered direct costs and 3% duplicative of CSC.[1] IHS Deputy Director Mary Smith, the agency point person on CSC policy, directed the agency's CSC team to re-run the data, using favorable assumptions to tribes, and see how close it could come to the tribal figure of 3%. On the re-run, IHS arrived at a figure of 5.4%, and Ms. Smith proposed a compromise figure of 4%.

[1] See our memorandum of January 21, 2016, pp. 4-6.

At the January 29 meeting, Ms. Smith announced that IHS is prepared to reduce the reduction-offset figure to 3.5%, pending a check on the financial implications of this figure for the agency. While a significant concession from 5.4%, let alone the unknown initial percentage, this figure was not immediately embraced by tribal representatives. Its acceptability depends on the larger context of the duplication policy, especially two issues: (1) what triggers a duplication analysis, and (2) how the "option A" in-depth analysis is carried out. A cornerstone of the tribal proposal going into the meeting was that duplication analysis would be prospective only, and that only significant new and expanded programs would be subject to the analysis—and even then, only on the incremental increase. At the meeting, IHS responded to the tribal proposal by accepting the general no-lookback rule, but proposing two "triggers" to a full duplication analysis: (1) a "material change" in the indirect cost pool, rate structure, or program operations; or (2) an "error" in the previous calculation comes to the attention of IHS.

After caucusing on the IHS proposal, tribes countered with the following language, which defines and narrows the "material change" language while rejecting the "error" trigger as too vague and open-ended.[2]

> The provisions of this section (E)(3) [i.e., the duplication options] shall apply to the negotiation of indirect CSC funding when: 1) an awardee assumes a new and expanded PFSA or added staff associated with a joint venture; or 2) an awardee includes new types of costs in the [indirect cost] pool associated with IHS programs that result in a change of more than 10% in the value of the [indirect cost] pool from the preceding year.

The make-or-break issue with respect to duplication appears to be whether the analysis applies to categories of funds or actual dollars. One example raised at the meeting was this: Suppose the Secretarial amount transferred to the tribe included one FTE for Information Technology (IT), and the Tribe's indirect cost pool includes funding for two such positions. Under the IHS categorical approach, since the Secretarial amount contained some IT funding, *all* of the IT funding in the indirect cost pool would be disallowed as duplicative. The tribal approach would acknowledge the actual funding for one IT position but would require IHS to fund the other position as indirect CSC. IHS made clear at the meeting that it would not accede to the tribal position. Ms. Smith explained that IHS is involved in litigation over the issue, but more importantly IHS does not believe the financial records are specific enough to support a dollar-for-dollar (as opposed to categorical) analysis. As Ms. Smith said frankly, "We are not going to agree on this in the short run." She proposed that the Workgroup draft around the issue by using "neutral" language that preserves both sides' positions. Some tribal representatives felt such an approach would leave the policy too open to the interpretation of the agency. This could be a difficult tightrope to walk as the Workgroup tries to nail down the final language of the draft policy.

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[2] As an alternative to striking the "error" trigger altogether, tribes discussed allowing a look-back when both IHS and the tribe agree on the error.

Finally, the question about Option B: 3.5% of what? The service unit budget generally includes substantial amounts generated by third-party billings. In that case, tribes argued that IHS would need to back out the third-party-funded portion of the service unit before applying the 3.5% reduction-offset. IHS seemed willing to accept this idea.

Costs Incurred

Discussion focused on proposed tribal edits to IHS's redline, which resulted in the following definition of direct costs (tribal edits shown in underline-strikeout):

a) Total direct costs will be used based on either:
   i) The eligible funding in the Secretarial amount plus the direct CSC funding (or the salaries ~~funded~~ paid for with IHS funds ~~by IHS~~ for those Tribes that use a salary base), if the total direct costs of the total health care program reflected in the IDC rate agreement or other documentation demonstrating prior-year expenditures are close to or exceed that amount; or
   ii) The total direct costs of the total health care program operated by the Tribe, if those costs as reflected in the IDC rate agreement are significantly less than the eligible funding in the Secretarial amount plus the direct CSC funding.

The first edit reflects the fact that tribes can re-budget their IHS funding and spend more on salaries than IHS did. IHS acknowledged the reallocation authority under the ISDEAA, but IHS's position is that the calculation of CSC need should be based on IHS's expenditures before transfer. IHS says it uses about 55% of its direct-service funding on salaries. So if, for example, IHS transfers a $1,000,000 program to a tribe, about $550,000 of that was for salaries, so IHS would say that none of the other $450,000 generates indirect costs for a tribe with a rate based on a salaries-only base. If the tribe decided to use the entire $1,000,000 for salaries (and pay administrative costs with third-party revenue), IHS would say that is the tribe's right, but the agency will pay indirect CSC only on that portion of the $1 million that is reasonably congruent with IHS expenditures of 55%. The salary "cap" IHS has been citing is 62%. This issue applies to tribes with rates based on total direct costs as well, since much of the $450,000 would be deemed passthrough or exclusion—for example, Purchased and Referred Care (PRC) funding. A tribe that paid for all its PRC with third-party revenues could ensure all of its IHS funding counts as direct costs that generate CSC funding. The parties have not reached agreement on whether this constitutes a legitimate strategic expenditure of funds or "gaming the system." Ms. Smith again proposed work-around language such as "in the interest of administrative economy, expenditures will be determined at the time of negotiation."

The other two edits above implement the presumption, borne out by the IHS study described in our January 21, 2016 memo, that tribes almost always spend all their funding, as defined by IHS as at least 90%. But while IHS thought 90% was close enough for the study to support the presumption, IHS would not agree to enshrine in the policy language stating that CSC would be paid on all IHS funding if "close to" all of it was spent. This would contravene IHS's interpretation of the ISDEAA as allowing CSC only for costs actually incurred in the contract year.

Finally, IHS appeared willing to accept the tribal proposal that reconciliation and close-out could be accomplished with an indirect cost rate up to three years old, rather than the two-year limit IHS had previously proposed. This would match the age limit for estimation of indirect cost funding at the beginning of the year.

Next Steps

- Feb. 3: IHS will provide its response to the tribal proposals on the two main issues discussed above.

- Feb. 4: Tribal Workgroup representatives will hold a teleconference to formulate a response to IHS's most recent redline.

- Feb. 5: Tribes will provide comments and proposed edits to IHS's most recent redline. Also, both sides will share examples that help to clarify, for example, what exactly IHS's proposed 3.5% reduction would be multiplied to, and how the tribes' proposed 10% cap on indirect cost funding reduction under the 3.5% offset would work.

- Feb. 8: IHS will hold an internal call to review the tribal comments and examples.

- Feb. 10-11: The full Workgroup will meet at the Crystal Springs Marriott near Washington, DC to work through the final issues and edit the draft policy language.

- Feb. 22-25: Assuming the federal and tribal sides can reach agreement, the Workgroup will roll out the draft policy at the NCAI Executive Council Winter Session.

Conclusion

We will continue to follow CSC developments in both IHS and BIA on your behalf. If you have any questions about this memorandum, please do not hesitate to contact Joe Webster (jwebster@hobbsstraus.com or 202-822-8282), Geoff Strommer, (gstrommer@hobbsstraus.com or 503-242-1745), or Steve Osborne (sosborne@hobbsstraus.com or 503-242-1745).