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MEMORANDUM

February 16, 2016

TO: Contract Support Cost Clients

FROM: HOBBS, STRAUS, DEAN & WALKER, LLP Geoff Strommer (by TAE)

RE: ***IHS CSC Workgroup Meets, Agrees on Rough Draft of CSC Policy; Administration Proposes Indefinite CSC Appropriations Again for FY 2017; Tribes Advocate Mandatory CSC Appropriations***

The Indian Health Service (IHS) Contract Support Cost (CSC) Workgroup met once again in an accelerated push towards finalizing a CSC policy this year. In meetings in Washington, DC on February 10-11, 2016, the Workgroup reached agreement on the last major issues and will release a draft policy for tribal consultation in the near future. In this memorandum, we report on the meeting and the draft policy, and we have attached a copy of the working draft for your review. We also report below on the Administration's FY 2017 budget proposal as it relates to CSC. Finally, we provide an update on tribal advocacy for permanent, mandatory CSC appropriations.

IHS CSC Workgroup Meets, Agrees on Rough Draft of CSC Policy

The Workgroup met for the fourth time in the last two months (along with numerous calls), reflecting the importance of finalizing a policy before the end of the current Administration. Despite this shared sense of urgency among federal and tribal representatives, progress has been anything but smooth. As chronicled in our previous reports, IHS's entrenched legal positions on duplication and "costs incurred" have made it difficult for the agency and tribes to negotiate solutions. After exchanging several redline drafts in the past few months, the parties arrived in Washington, DC unsure of whether they could bridge the gulf dividing them on these major issues. Below we briefly describe these issues and how the draft policy deals with them. We then describe the next steps in the process of finalizing the draft and sending it out for tribal consultation.

Costs Incurred

The theory that CSC entitlements are limited to expenditures, rather than amounts owed under the ISDEAA and the indirect cost rate agreement, continues to drive IHS policy as well as the claims settlement process. The draft policy, however, reflects significant compromises on the part of IHS as well as tribes. These issues affect both the estimation of CSC at the beginning of the year and reconciliation and closeout at the end of the year.

At the beginning of the year, IHS estimates the full amount of CSC requirements based in part on how much was expended (incurred) in the previous year. On pages 13-14 of the attached draft, section "a." outlines two methods for estimating direct costs (and thus indirect cost needs). Most tribes will fall under subparagraph i), which essentially says IHS will assume the Tribe will spend its entire IHS funding amount if it has done so in the past. Footnote 1 explains that IHS has looked at the data and concluded that "the substantial majority" of tribes spend all of their funding.[1] Some tribes, however, will fall under subparagraph ii), which says that if a tribe spends less than the Secretarial amount (plus direct CSC) IHS will pay indirect costs based only on the amounts expended.

For the purpose of the front-end estimation, IHS agreed to use either an indirect cost rate for the contract year, or the most recent approved rate, up to three years old. On the back end, however, when reconciling CSC payments to expenditures, IHS felt that the need for accuracy outweighs such flexibility. For the past year or more, IHS has insisted that it cannot close out any year without a fixed-with-carryforward rate for that year (or a final rate, for those with provisional-final rates). For some tribes, this could be years, as rates may be unavailable for a number of reasons. Tribes sought the same flexibility on the back end as the front: reconciliation using the most current rate up to three years old. As a compromise, the draft policy allows reconciliation using a rate from either the contract year or the year before. This incentivizes tribes to keep their rates current, which is beneficial for several reasons. The policy builds in a "transitional period" in which IHS agrees to use a rate up to three years old to close out.[2]

Tribes pushed hard to get IHS to accept rates up to two years old for reconciliation, but IHS Deputy Director Mary Smith said she had taken the issue to the highest levels of the Health and Human Services' legal office and been turned down. She said IHS made a significant compromise in allowing use of a rate even one year older than the contract year.

<u>Duplication</u>

The new policy will institute a process for assessing duplication between the indirect cost pool and administrative costs funded as part of the service unit funding included in the Secretarial or 106(a)(1) amount. The mechanism will be similar to the familiar 80/20 rule for Area and Headquarters tribal shares, in which 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. In addition to the 80/20 tribal shares reduction, under the new policy tribes will also be subject to another reduction-offset for service unit funding.

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[1] See our report of January 21, 2016 for a description of the IHS study—which, favorably to tribes, assumed tribes spent all their IHS funding first, so if the total health program expenditures exceeded the IHS-appropriated amount, the tribe was presumed to have spent all IHS funds.

[2] See footnote 2 on page 15.

In theory this makes sense, since the Indian Self-Determination and Education Assistance Act (ISDEAA) prohibits duplication—funding the same costs twice, both in the program amount and as CSC—and tribes often receive some funding that IHS would otherwise use as service unit administrative or indirect-type costs. The IHS CSC policy has long required adjustments to remove duplication, but most tribes and tribal organizations have never been scrutinized closely for this type of duplication.

How big will the offset be? Tribes proposed 3% of service unit funds as a default rule—a figure apparently far below the one IHS arrived at based on a study of its service units. IHS countered with 5.4%, then 4%, then 3.5%. Ultimately IHS accepted the tribal proposal of 3%, and the draft policy includes the "97/3" rule. According to tribal representatives whose organizations have undergone a detailed duplication analysis, the 3% figure is quite favorable to tribes. Still, it will result in a substantial cut, first as a reduction of the direct cost base, and then as an offset against indirect CSC. For example, for a tribe with a $1,000,000 base and a 30% indirect cost rate, the direct cost base would be reduced by $30,000, costing the tribe $9,000 in indirect cost funding. Worse, the imputed service unit administrative funding is then counted as indirect costs recovered, lowering by $30,000 the indirect CSC paid by IHS.

Alternatively, a tribe can elect to undergo a detailed case-by-case negotiation with IHS to determine the actual duplication amount. This would make sense for tribes that have little or no duplication because they operate limited programs, such as Purchased and Referred Care, but do not contract service unit shares. But this alternative will not be friendly to most tribes due to IHS's insistence that duplication will be identified based on "activities" rather than funding. For example, if a tribe has maintenance costs of $100,000 and the Secretarial amount includes (according to IHS) $1,000 for maintenance, the tribe will not be able to recover the other $99,000 as CSC. Because the "activity" (or category) of maintenance in included in the Secretarial amount, no funding for the same activity can be paid as CSC. The tribal position is that only the $1,000 Secretarial amount for maintenance is precluded from recovery as CSC, and the other $99,000 is properly charged and recovered as indirect CSC. This issue, which turns on interpretation of sections 106(a)(2) and 106(a)(3) of the ISDEAA,[3] is currently being litigated, and is another issue Ms. Smith said was taken to the highest legal levels in the Department. The draft policy will contain a footnote describing each side's legal position. (IHS also said that acceding to the tribal position on this issue would cost the Government $600 million to $1 billion, but this seems wildly overstated and the agency could not provide a coherent explanation of its calculations at the meeting.)

Tribal representatives sought to limit the effect of the new duplication analysis by making it prospective only. Tribes that assumed programs, functions, services, and activities (PFSAs) in the past would not be subject to the 3% reduction-offset or the

[3] 25 U.S.C. § 450j-1(a)(2) & (3).

detailed analysis unless something occurred to "trigger" the duplication analysis. IHS ended up accepting this "grandfather" provision, but sought to expand the triggers, while tribes fought to narrow them. As laid out in section 3 on pages 16-17 of the draft policy, IHS will open up a duplication review in the following circumstances:

- assumption of new or expanded PFSAs, or a new joint venture (with the review extending only to the new or expanded PFSAs or the extra staff for the joint venture, not the entire program);
- the indirect cost pool includes new types of costs resulting in a change of more than 2% of the pool's value[4]; or
- if the awardee proposes and completes a renegotiation of the duplication amount.

IHS sought broad discretion to delve into duplication whenever it had "knowledge" that a tribe's duplication was higher than currently accounted for. Tribes were able to convince IHS to drop this provision in light of a disclaimer IHS plans to insert stating that nothing in the policy impairs IHS's ability to exercise its rights and responsibilities under the ISDEAA. (A similar disclaimer preserving tribal rights under the ISDEAA appears in the first flush paragraph on page 3 of the attached.)

Next Steps

The attached draft of the policy reflects the Workgroup's resolution of the major issues, but is quite rough. Over the next few days, Workgroup members and their technical advisers will have the opportunity to offer comments and edits, although both sides urged that any editing be "restrained." The policy will then proceed along the following schedule:

- Feb. 17: IHS and tribal representatives exchange comments and proposed edits.

- Feb. 18: Workgroup holds teleconference to discuss and make decisions on proposed changes. The group will also develop a timeline to revise the exhibits to the policy.

- Feb. 19: IHS releases draft to tribes via IHS website.

- Feb. 22: IHS and tribal Workgroup representatives will hold an informational session on the draft policy at the NCAI Executive Council Winter Session in Washington, DC.

[4] Tribes had proposed a 10% threshold, but IHS proposed 2%, then no threshold at all, with any change in rate "structure" enough to trigger duplication review. Tribes were able to knock out the vague "rate structure" trigger, but could not get IHS above the 2% threshold.

Although the policy itself is near completion, the Workgroup must develop the exhibits, including revising the useful "Standards for the Review and Approval of Contract Support Costs" document and developing a new exhibit on the Annual CSC Calculation (ACC) tool. The Workgroup will meet on March 28-29 to finalize the exhibits. IHS envisions a comment period from about April 1 to May 31, with the policy finalized next summer.

Neither IHS nor tribal representatives are entirely satisfied with the draft, which required months of intense negotiations and reflects significant compromises on both sides. Most tribal representatives believe it is the best deal tribes are likely to get from IHS, and possibly much better than could be obtained from the next Administration.

Administration's FY 2017 CSC Proposal

The Administration proposes for FY 2017 to continue the FY 2016 enacted policy of CSC being an indefinite appropriation—"such sums as may be necessary"—in a separate account in both the IHS and the Bureau of Indian Affairs (BIA) discretionary budgets. The estimated amount listed for IHS CSC in the Explanatory Statement is $800 million ($82 million over the FY 2016 estimate), with IHS noting that the estimate will be adjusted as new information becomes available, and the estimated amount for the BIA is $278 million ($1 million over the FY 2016 estimate). However, because the CSC accounts are indefinite and separate, there is no funding cap, and program funding would not be reprogrammed to cover unmet needs if the estimated amounts prove insufficient. Rather, the agencies could seek additional funding from the Treasury.

The proposal would also continue problematic bill language from FY 2016 in both the IHS and BIA CSC sections: "amounts obligated but not expended by a tribe or tribal organization for contract support costs for such agreements for the current fiscal year shall be applied to contract support costs otherwise due for such agreements for subsequent fiscal years." This language can be misread to endorse IHS's "costs incurred" interpretation of the ISDEAA, which holds that Tribes are only entitled to the amount of CSC expended in a given year—effectively denying the carryover authority granted by the ISDEAA. Requiring an offset against the succeeding year's CSC entitlement for unspent CSC upends the indirect cost rate-making process as well as tribal budgets. Tribes have already begun advocating that this language be removed in FY 2017.

The Administration's proposed IHS CSC bill language is:

> For payments to tribes and tribal organizations for contract support costs associated with Indian Self-Determination and Education assistance agreements with the Indian Health Service for fiscal year 2017, such sums as may be necessary. *Provided,* That amounts obligated but not expended by a tribe or tribal organization for contract support costs for such agreements for the current fiscal year shall be applied to contract support costs otherwise due for such

> agreements for subsequent fiscal years; *Provided further*, That, notwithstanding any other provision of law, no amounts made available under this heading shall be available for transfer to another budget account.

Similarly, the proposed BIA CSC bill language is:

> For payments to tribes and tribal organizations for contract support costs associated with Indian Self-Determination and Education assistance agreements with the Bureau of Indian Affairs for fiscal year 2017, such sums as may be necessary which shall be available for obligation through September 30, 2018. *Provided*, That amounts obligated but not expended by a tribe or tribal organization for contract support costs for such agreements for the current fiscal year shall be applied to contract support costs otherwise due for such agreements for subsequent fiscal years; *Provided further*, That, notwithstanding any other provision of law, no amounts made available under this heading shall be available for transfer to another budget account.

Administration's Proposal for Mandatory CSC Funding in FY 2018 and Beyond

The Administration also proposes to reclassify CSC – beginning with FY 2018 – as a mandatory, 3-year appropriation "with sufficient increases year to year to fully fund the estimated need for the program, for both the IHS and BIA." The IHS budget justification indicates the following estimated mandatory amounts, while noting that "new CSC estimates will be provided as part of the reauthorization process."

FY 2018 - $ 925,000,000
FY 2019 - $1,100,000,000
FY 2020 - $1,300,000,000

While the proposal to reclassify CSC as mandatory funding is encouraging, the amounts would be capped rather than indefinite. Finally, the IHS proposes that "a small amount of CSC can be used for program management and integrity, for example, 2 percent." This 2 percent set-aside was also part of the Administration's proposal for FY 2016, which included a similar three-year mandatory appropriation beginning in FY 2017, and the set-aside was not supported by Tribes.

As of this writing, the BIA Budget Justification was not available, so we do not have comparable estimates for FYs 2018, 2019 and 2020. The Federal Budget Appendix provides proposed bill language, but does not contain this information.

Long-Term CSC Strategy

There is ongoing discussion of how to proceed on CSC appropriations issues for FY 2017 and beyond. This year will be a shortened Congressional session – cut short by recesses for the Democratic and Republican conventions and the usual adjournment a month prior to the November election. In addition, House Speaker Ryan is expediting consideration of appropriations bills this year. For instance, House appropriations hearings will be done before the end of March and the House is expected to be marking up its appropriations bills in April. Given the shortened time line and the effort it took to obtain a one-year indefinite CSC appropriation in FY 2016, most tribal advocates believe we should focus our FY 2017 CSC effort on removing the carryover proviso and keeping the CSC appropriation at an indefinite level, then work for a longer-term solution after the elections. But even if we limit the effort to maintaining the FY 2016 CSC policy except for the carryover proviso, we should not lose sight of the long-term solution: a permanent, indefinite mandatory appropriation. Tribes should seek advice from supportive Committee staff and Members on ways to make an indefinite appropriation, like the FY 2016 appropriation (but without the proviso) permanent and mandatory. The attached draft white paper contains much more detail on the mandatory appropriations initiative and next steps tribes should consider.

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).