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## MEMORANDUM

February 2, 2015

TO: Contract Support Cost Clients

FROM: HOBBS, STRAUS, DEAN & WALKER, LLP /s/

RE: ***President's FY 2016 Budget Proposes Mandatory CSC Appropriations;  
IHS CSC Workgroup Meets in Washington, DC***

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The President's FY 2016 Budget, released earlier today, includes a proposal to establish mandatory contract support cost (CSC) appropriations for both the Indian Health Service (IHS) and the Bureau of Indian Affairs (BIA). This exciting development represents a major step forward for tribes and tribal organizations. If approved by Congress, mandatory CSC appropriations would ensure that CSC is paid in full without reducing program funds—a result that all tribes have sought. In this memorandum, we describe the mandatory CSC proposal and also discuss a meeting last week of the IHS CSC Workgroup in Washington, DC.

### ***Mandatory CSC Proposal***

In its explanatory statement accompanying the FY 2014 appropriations act, Congress called on tribes and the agencies to work together on long-term solutions to CSC challenges.<sup>1</sup> Tribes and tribal organizations have advocated for mandatory CSC funding as the centerpiece of these solutions. At present, CSC is paid out of the agencies' discretionary lump-sum appropriations, so fully funding CSC in FY 2014 required cuts to programs and services—an outcome condemned by direct service, self-determination, and self-governance tribes alike. Making CSC a separate, mandatory appropriation would prevent competition between CSC and program funds and avoid the painful reprogramming of funds from health care services that IHS was forced to do in FY 2014.

Under the proposal, FY 2016 would be spent consulting with tribes and working with Congress on the details of the proposal. There would be three years—FYs 2017, 2018, and 2019—of capped mandatory funding (see chart below), after which it would need to be reauthorized. Any funds not used in one year would carry over to the following year. In a call earlier today announcing the proposal, Acting IHS Director Dr. Yvette Roubideaux and Assistant Secretary – Indian Affairs Kevin Washburn said they believe the amounts are "generous" and thanked the CSC workgroups for all their help on this matter.

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<sup>1</sup> See our report of January 26, 2015 and attached Dear Tribal Leader letter.

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**PRESIDENT'S REQUEST FOR CONTRACT SUPPORT COSTS**

<b>FY 2016 (discretionary)</b>	<b>FY 2017 (mandatory)</b>	<b>FY 2018 (mandatory)</b>	<b>FY 2019 (mandatory)</b>
<b>IHS:</b> \$718 million (\$55 million increase over FY 2015)	<b>IHS:</b> \$800 million	<b>IHS:</b> \$925 million	<b>IHS:</b> \$1.1 billion
<b>BIA:</b> \$277 million (\$26 million increase over FY 2015)	<b>BIA:</b> \$307 million	<b>BIA:</b> \$322 million	<b>BIA:</b> \$338 million

New mandatory funding is subject to the PAYGO Act, which requires an offset from other mandatory funding. The Appendix to the proposed 2016 budget, under BIA Operation of Indian Programs, states that subject to PAYGO, "The Administration proposes a long-term approach to fully funding tribal contract support costs by reclassifying both BIA and IHS contract support costs to mandatory funding beginning in FY 2017."

In a call earlier today announcing the proposal, tribal leaders consistently made the point that the IHS and BIA have been consulting with tribes for a year on a long-term solution to fully funding CSC and thus further consultation should be expedited. As discussed below, tribal representatives at the Workgroup meeting called for expedited consultation so the necessary authorization can be enacted for FY 2016 rather than waiting for FY 2017. Dr. Roubideaux has stated that the Administration would not object to an accelerated schedule for implementing the proposal if Congress can be convinced. She noted that there are upcoming events—e.g., NCAI Executive Council Winter Session, IHS and HHS budget meetings—at which additional consultation can occur.

The IHS Budget Justification is scheduled to be released on February 3, 2015 and the (Interior) Indian Affairs budget on February 3 or shortly thereafter. There should be more detail in these budget justifications. On the call today, IHS indicated that OMB wants questions about the proposal to be directed to it.

The Administration's proposal differs in some respects from the legislative proposal our firm developed last year,<sup>2</sup> and that was endorsed by NCAI, NIHB, and many

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<sup>2</sup> See our memorandum of April 4, 2014 and attached White Paper, "Proposal to Enact Permanent Mandatory Appropriations for Contract Support Costs Under the Indian Self-Determination and Education Assistance Act." See also Geoffrey Strommer, et al., *Payment of Contract Support Costs is Mandatory; Why Isn't the Funding?*, INDIAN COUNTRY TODAY (May 2, 2014), available at <http://indiancountrytodaymedianetwork.com/2014/05/02/payment-contract-support-costs-mandatory-why-isnt-funding>.

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other tribal organizations. We proposed establishing CSC as a permanent, indefinite appropriation similar to that for other legal entitlements. The President's proposal appropriates specific sums for three years. Nonetheless, the proposal would achieve, at least for three years, the central goal that tribes want: to fully fund CSC without reducing program funding for any tribe, whether Self-Governance, Title I, or direct service. While the appropriation is not indefinite, the dollar amounts appear to be high enough to achieve the same effect, as they should be ample to fully fund CSC nationally for the three-year period. And while the appropriation is not permanent, establishing CSC as a mandatory appropriation would set an important precedent that Congress could later renew for an additional term or make permanent.

The inclusion of the mandatory CSC proposal in the President's Budget represents a significant victory for tribal advocates. Senator Begich introduced a bill in the last Congress that would have established mandatory CSC appropriations,<sup>3</sup> but the Administration never spoke out in support of the idea, and the bill died. This year, the support of the President, OMB, IHS, and BIA, combined with strong tribal advocacy on the issue, may make Congress more likely to enact mandatory CSC appropriations.<sup>4</sup> The limited duration and amount of the proposal may also make it easier for Congress to swallow than a permanent, indefinite appropriation. We encourage you to support the Administration's proposal with your Congressional delegation. Please let us know if you would like our assistance in doing so.

### *IHS CSC Workgroup Meeting*

The Workgroup convened in Washington, DC on January 29-30, 2015. Dr. Roubideaux opened by thanking the Workgroup for its help in FY 2014 as the agency adapted to the full-funding environment. She said the Workgroup's recommendations for long-term solutions remain under consideration by the Administration. None of these recommended solutions were implemented in time for FY 2015, so it remains possible that IHS will need to reprogram funds to pay full CSC this year, although with a \$76 million increase that seems unlikely. Dr. Roubideaux was authorized to describe the mandatory appropriations proposal in general terms. She said it was a "huge lift" to get the Administration to support mandatory spending of any kind, and credited the Workgroup's accomplishments in improving pre-award estimates of full CSC need with swaying decision-makers at OMB and the White House. The goal of the present meeting, she said, was to continue refining CSC calculation tools, which would help persuade Congress to enact the mandatory appropriations proposal.

Dr. Roubideaux said that the watchwords of the new Congress appear to be "oversight" and "accountability"—which also are key components of mandatory

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<sup>3</sup> S. 2669. See also our report of July 16, 2014 (discussing introduction of bill).

<sup>4</sup> At the CSC Workgroup meeting discussed below, Dr. Roubideaux stressed that OMB played an important role in drafting what it felt was a workable proposal for Congress.

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entitlements like Medicare and Medicaid. Congress will need to be convinced that CSC needs are reasonable, verifiable, and relatively predictable. Tribes and the Administration will need to stress these themes in a unified message urging Congress to enact the mandatory appropriations proposal.

### *Reconciliation in FY 2014 and Beyond*

Reconciliation refers to IHS's process of updating data on the variables driving each contractor's CSC need to determine whether the agency must pay more or recover amounts overpaid. IHS continues to update FY 2014 data three months after the close of the fiscal year, making payments and collecting overpayments of FY 2014 CSC dollars. More disturbingly, IHS said it envisions the FY 2014 reconciliation process continuing for years to come. For example, when FY 2014 provisional indirect cost rates become final, which can take two years, IHS will pay out more if the final rate is higher, and seek to recover funds if the rate comes in lower. In fact, IHS said it will hold onto some FY 2014 CSC funding for up to five years—until the appropriation lapses and the balance reverts to Treasury—in order to pay any additional CSC needs retroactively identified.

This revelation raised at least three concerns. First, how much FY 2014 funding has IHS held back—funding that could have been spent on services in FY 2014, and that could ultimately go unspent? IHS could or would not answer that question, saying only that the amount is dynamic, as funds continue to be paid out and recovered. Second, tribal representatives were troubled by the specter of IHS presenting a bill three or more years down the road for an overpayment in FY 2014. They argued that finality is essential, and that changes occurring after the end of the year should not affect the calculation of need for that year. IHS agreed that closing the books for good at the end of the year would be ideal, but said it feels obligated, under the full-funding mandate, to pay in full no matter how long it takes.<sup>5</sup> Third, tribal representatives expressed concern that IHS does not have the staffing to reconcile not only the current year's CSC needs and payments but also those of the five previous years. IHS shared this concern.<sup>6</sup>

The reconciliation and finality issues will need to be addressed, likely through policy manual revisions and funding agreement language. Receiving or (worse) having to pay additional FY 2014 CSC years later would not only disrupt budgets but also throw off audits, indirect cost rate proposals, and other financial documents.

In FY 2015, IHS made its first CSC payments based on adjusted FY 2014 data. IHS plans to have its first reconciliation complete by mid-February, at which point the

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<sup>5</sup> IHS appears to be worried not only about Contract Disputes Act claims for underpayment, but also Anti-Deficiency Act violations for obligations in excess of appropriations.

<sup>6</sup> Reconciliation appears to be primarily a Headquarters function. IHS said all of the data comes from the Areas. Headquarters is able to check self-governance tribes' data against the Office of Tribal Self-Governance database, but is not able to perform a similar cross-check for Title I contracts.

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agency should be able to update tribes on the CSC budget and whether it is on track to avoid reprogramming. IHS promised to provide a roll-up of CSC expenditures to date, to show where they stand with respect to the \$663 million CSC allocation for FY 2015.

As discussed in the Director's recent "Dear Tribal Leader" letter,<sup>7</sup> IHS intends to reconcile CSC needs and payments on a monthly basis for internal purposes such as tracking CSC expenditures, estimating further increases, and gauging the likelihood of reprogramming. At the meeting, IHS clarified that it will not make payments or reimbursement demands monthly, but will only initiate reconciliation negotiations with tribes later in the fiscal year as it did in FY 2014.

### *Annual CSC Calculation Template*

Over the past six months or so, IHS has rolled out a CSC needs estimation tool that may also serve other purposes. At the Workgroup meeting, IHS presented a refined version of the spreadsheet, which the Workgroup dubbed the Annual CSC Calculation (ACC) template or tool. Essentially the ACC contains the same data as the old shortfall reports: the variables driving CSC needs—program base, exclusions, tribal shares, indirect cost rate, and direct CSC (DCSC)—the resulting needs, and the amounts paid. The ACC is already used widely, although not universally, among the IHS Areas, and IHS proposed to apply it uniformly starting this year. Ultimately the Workgroup formally endorsed the ACC, a copy of which is attached, but several of the variables required considerable discussion.

Passthroughs and exclusions continue to be a negotiation wild card, although the Workgroup has agreed on the basic approach. IHS will first look to the indirect cost rate proposals—which it reportedly is now receiving routinely from the Interior Business Center (IBC) and the Division of Cost Allocation (DCA)—to determine the types of passthroughs and exclusions to apply. IHS will also consider other documentation justifying a variance from the proposal or establishing the amounts to deduct from the program base. If the rate proposal is not available, and the tribe provides no other documentation to establish the type and amount of passthroughs and exclusions, IHS will apply the Exclusions Matrix developed by the Workgroup that establishes "default" treatment of funding categories.<sup>8</sup>

One of the ACC variables is the non-medical inflation rate, which is multiplied by the previous year's DCSC need to generate the current year's need. Tribal Co-Chair Andy Joseph continued to push IHS to apply the higher *medical* inflation rate, since DCSC is primarily composed of fringe benefits for medical providers, for whom tribes often

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<sup>7</sup> See our report of January 26, 2015 for a discussion of the letter, which is available at <http://www.ihs.gov/newsroom/triballeaderletters/>.

<sup>8</sup> See our report of January 15, 2014 for a discussion of the Workgroup's initial discussions of the Exclusions Matrix, a copy of which is attached.

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struggle to provide competitive compensation packages. This issue will be addressed when tribal representatives re-draft the IHS CSC Policy.

Rather than accept the previous year's amount of DCSC plus inflation, a tribe can always ask to renegotiate its DCSC need. As we have previously reported, however, IHS recently recalculated the amount of fringe-type costs it believes are already included in the Secretarial amount and thus cannot be duplicated in DCSC. The recalculation, based on nationwide data from IHS direct operations in FY 2013, has resulted in much lower estimates of DCSC need on the part of IHS. Tribal representatives requested the FY 2013 data on which the recalculation was based, and IHS agreed to provide it.

Going forward, IHS sees the ACC serving multiple purposes. In the pre-award negotiation phase, it would be a "conversation-generating" tool helping the parties collaboratively establish the initial amount of CSC due at the beginning of the contract year. As a reconciliation tool, it would be repopulated with each modification of a CSC variable—such as an addition to program funding or a change in the indirect cost rate—to ensure that CSC keeps pace with (but does not outpace) total need. As a reporting tool, the ACC could be used to aggregate data from individual tribes into Area-wide and national CSC funding reports.

Finally, the Workgroup agreed that the ACC could help convince Congress to adopt the mandatory appropriations proposal. The spreadsheet makes CSC needs calculations simple, transparent, and consistent. All of the numbers in the calculation are verifiable, as they tie to other documents such as the funding agreements and indirect cost rate agreements. Much like the Exclusions Matrix, which Dr. Roubideaux has said several times helped convince decision-makers to support full CSC funding, the ACC functions as a tangible demonstration that CSC need calculation is simple, rational, fair, uniform, verifiable, and systematic. The Workgroup began to develop talking points, which the Technical Workgroup will elaborate, that stress the tribal-federal partnership in developing concrete tools to ensure that the CSC funding process includes continuous oversight and accountability, characteristics essential to mandatory appropriations.

Tribal representatives embraced the ACC with varying degrees of warmth, with some expressing concern that training would be needed for tribal and Area personnel in order for the template to be applied consistently. On the whole, however, tribal representatives agreed that the ACC is a useful tool for negotiation, payment, reconciliation, and perhaps lobbying.

### *Multi-Year Lump-Sum and Flat-Rate Agreements*

The Workgroup continued its discussion of alternative methods that would simplify the process of determining CSC needs by eliminating one or more of the variables. Lee Olsen of the Southcentral Foundation presented a paper, a copy of which is attached, proposing that one option be to negotiate a lump sum for CSC that would

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carry forward for an agreed number of years with only simple inflation adjustments each year for DCSC (using the medical rate) and indirect CSC (the non-medical rate).<sup>9</sup> This would eliminate the need for reconciliation altogether, and would provide both the contractor and the agency with greater certainty. This option might be especially attractive to mature organizations with stable indirect cost rates and no plans to expand.

A similar multi-year solution would be to adopt a multi-year indirect cost rate, which would eliminate that major variable and provide stability and predictability. Precedent for this option exists in the IHS CSC Pilot Project that began in 2002 and was generally well received by tribes. IHS provided the Workgroup some documents establishing the terms of the Pilot Project.

IHS agreed that both options would simplify CSC needs calculations, but worried that strong contractual language would be necessary to enforce the commitment. Tribal representatives plan to build both options into their re-write of the IHS CSC Policy, and will also draft sample contractual language.

### *Upcoming Issues*

Although the following issues were not addressed in any detail at the Workgroup meeting, IHS identified significant issues that it believes require in-depth discussion:

- **Duplication:** IHS believes that the Secretarial amount awarded to tribal contractors contains funding for some costs captured in the indirect cost pool (as well as for functions otherwise eligible to be funded as DCSC, as discussed above). IHS is beginning to look at duplication more closely in negotiations.
- **Funding Agreement Language:** When Congress mandated full CSC funding in FY 2014, IHS initially insisted that the additional CSC payments be issued with "bilateral" amendments, meaning that the tribal contractor as well as IHS would have to sign off on the amendment and agree that the amount paid represented the full CSC need based on the information available on that date. Tribes preferred unilateral amendments, which would greatly expedite payment, and IHS eventually agreed. But IHS continues to believe that bilateral language is needed to protect the agency, especially when the CSC need drops below the level then identified in the funding agreement.

### *Next Steps*

The Workgroup plans to meet by teleconference on Wednesday, February 4 to discuss the mandatory CSC proposal in more detail and plan the next in-person meeting.

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<sup>9</sup> The proposed language included a provision that an increase in the direct cost base exceeding a certain amount, approximately 10% of the current base, would trigger renegotiation of the lump sum.

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Meanwhile, the Technical Workgroup has been charged by the full Workgroup with (1) elaborating the talking points in support of the mandatory CSC proposal; (2) developing policy manual and contract language for the lump-sum and fixed-rate options; and (3) beginning a comprehensive revision of the policy manual.

***Conclusion***

The Administration's inclusion of the mandatory CSC appropriations proposal in the FY 2016 Budget is a huge achievement for tribes, but Congress now must be convinced to adopt it. We will continue to follow and support these efforts, as well as the IHS and BIA CSC Workgroups, on your behalf.

If you have any questions about this memorandum, please do not hesitate to contact Joe Webster ([jwebster@hobbsstrauss.com](mailto:jwebster@hobbsstrauss.com) or 202-822-8282), Geoff Strommer ([gstrommer@hobbsstrauss.com](mailto:gstrommer@hobbsstrauss.com) or 503-242-1745), or Steve Osborne ([sosborne@hobbsstrauss.com](mailto:sosborne@hobbsstrauss.com) or 503-242-1745).