

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health, Education, and Welfare

SUBJECT: California Department of Benefit Payments DATE: December 14, 1979
Docket Nos. 78-57-CA-SS
 78-59-CA-SS
Decision No. 71

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CHAIRMAN'S DECISION

I. Procedural Background.

This decision is the final step in the reconsideration process provided in Section 201.14 of Title 45 of the Code of Federal Regulations, implementing Section 1116(d) of the Social Security Act. Section 1116(d) entitles a State to receive upon request reconsideration of disallowances under certain titles of the Social Security Act including Titles IV-A, X, and XIV. Docket No. 78-57-CA-SS ("Lake County") arises from a disallowance issued on March 24, 1976, by the Regional Commissioner of the Social and Rehabilitation Service ("SRS"), disallowing \$962.50 in Federal financial participation ("FFP") claimed by the State under Titles IV-A, X, and XIV. Docket No. 78-59-CA-SS ("Alameda County") arises from a determination issued on October 6, 1975, by the Regional Commissioner, SRS, disallowing \$194,302.53 in FFP claimed by the State under Title IV-A. The determinations were reviewed under the reconsideration process and were consolidated for purposes of a conference held with the Administrator of SRS on October 19, 1976. They were transferred to the Social Security Administration when the SRS was abolished, and on June 7, 1978, the then Acting Commissioner of Social Security issued decisions upholding each of the disallowances.

By letter dated July 3, 1978, addressed to the Acting Commissioner, the State requested further reconsideration by the Chairman of the Departmental Grant Appeals Board. Although the State was entitled under 45 CFR 201.14, as amended March 6, 1978 (43 FR 9266), to exercise an option to have the matter considered by the Board under 45 CFR Part 16, it expressly chose not to do so but to be governed by the Section 201.14 procedure with the Chairman substituted for the Administrator, SRS, in accordance with the transfer of functions of March 6, 1978 (43 FR 9266-7).

Under the transfer of functions, the State was entitled to a conference with the Board Chairman and requested one. Accordingly, by a Notice of

Conference dated May 31, 1979, I gave notice that such a conference would be held, invited the parties to suggest agenda items for the conference, and directed them to come prepared to discuss certain questions present in the case and also the correctness of the preliminary analysis of facts and issues set forth in the Notice. The conference was held on July 30, 1979. A transcript was made at the State's expense in accordance with Section 201.14(d)(7) and is part of the file. Both parties have been afforded an opportunity to review and propose corrections to the transcript. At the conference the parties were afforded the opportunity to discuss the questions that had been placed on the agenda as well as others that arose for discussion in the course of the conference and were invited to file post-conference briefs which have since been received. In addition, new issues having been raised, each party was permitted to file a reply to the other party's post-conference brief.

During proceedings in these cases, two basic issues have been considered: (1) whether the State audits relied upon by the agency provided a sufficient basis for identifying erroneous payments; and (2) whether, if the amounts do in fact represent erroneous payments, the State must return the full Federal share, regardless of how low an error rate the State had achieved. Based on the findings of fact and conclusions of law set forth below, I have determined upon reconsideration that the specific State audits here do not provide a sufficient basis for individually identifying erroneous payments according to Federal standards. I do not, therefore, reach the issue of liability for erroneous payments.

Background

The primary means of reducing errors in State grant-in-aid programs is through a quality control system designed to identify payment errors through careful examination of a representative sample of assistance cases and determination of an error rate which is then extrapolated to the program universe. Through regulations first proposed in 1973, HEW attempted to provide for disallowances of FFP for those States in which the quality control determined error rate was not within certain tolerance levels. A successful court challenge to the particular tolerance levels utilized resulted in the decision of Maryland v. Mathews, 415 F. Supp. 1206 (D.D.C. 1976). HEW revoked the disallowance provisions and announced that, until it could establish acceptable levels, it was returning to a system of disallowing FFP only in individually identified erroneous payments. 42 FR 14717, March 16, 1977.

In this context, the Regional Commissioner determined that certain audits, performed by the California State Controller's Office ("SCO"), which referred to "categorical aid overpayments" provided a basis for disallowance on grounds that the audits individually identified erroneous payments. In determining to utilize the State audits, the agency apparently relied on the reputation

of the SCO and on general statements to the effect that the audits were performed in accordance with generally accepted accounting principles. The agency did no testing to determine whether the audits were in fact performed in accordance with generally accepted principles or whether the audits otherwise met HEW requirements. Although the State requested the agency to examine the audit workpapers, the agency declined until the State submitted some of those papers at the conference.

Alameda County Audit

The disallowance in the Alameda County case was based on an SCO audit for the period July 1, 1972 through September 30, 1973, covering three Alameda County public assistance programs: Aid to Families with Dependent Children ("AFDC") - Family Group, AFDC - Unemployed, and AFDC - Boarding Homes and Institutions. The SCO policy stated in the audit report was to limit recoveries of State and Federal funds for the audit to "errors actually observed in the months which were audited." (Alameda Audit Report, p. 1.)

The auditors reviewed the county's internal controls, listing the results of their review as "findings" with corresponding "recommendations." Under the heading "Overpayments: a. Abatement of State Claims," the following appears in the "findings" column:

A review of County policies and procedures...and discussions with personnel responsible for the handling of reported categorical aid overpayments...revealed that this County is not adjusting its assistance expenditure claims for amounts previously claimed but subsequently found to be ineligible for State and Federal participation... A review of fiscal records showed for the audit period July 1, 1972 through September 30, 1973 there were 2,118 reports of categorical aid overpayments which were found to be uncollectible due to administrative error totalling \$388,605.06.

(p. 14)

At the conference, the State submitted documents which were identified without contradiction as the auditors' workpapers used to calculate the \$388,605 in "overpayments." These workpapers are monthly recaps summarizing reports by county workers of amounts determined by them to represent non-collectible overpayments to assistance recipients. While the summaries cover a number of assistance programs, including Food Stamps and county relief, the auditors obtained their figures through adding only those figures related to certain categorical aid programs. In doing this, however, they exceeded the scope of their audit of the three AFDC programs and, also, according to uncontradicted statements made by the State during proceedings in this case, included programs certain portions of which are not subject to Federal participation.

County and State regulations (copies of which were submitted at the conference) indicate, contrary to the State's assertion in this case, that the overpayments were probably identified as "non-collectible" because they were due to administrative rather than client error. On the other hand, the definition of "overpayment" employed to identify the summarized amounts is different from the definition of erroneous payment employed in the Federally regulated quality control system, and includes, for instance, aid paid pending an eligibility determination appeal. Furthermore, the summaries do not indicate when the overpayments were made, only when they were reported as non-collectible.

The auditors identified the case of Marin County v. Martin, discussed below, as the reason for the County's failure to adjust for overpayments and recommended that the County make adjustments for amounts previously claimed but found to be ineligible for State and Federal participation. The auditors did not recommend disallowance action by the State nor apportion the \$388,605 among the various funding sources.

The auditors did specify that \$3,206.23 was the Federal share in \$6,308.14 (thus, slightly more than 50%) in specific exceptions related to the audited programs and set forth in the audit report. These exceptions were apparently identified after the computation of the County summaries and thus presumably not included in them. They were not all taken on the basis of a determination that an actual error in payment had been made, some being based on lack of documentation. State rather than Federal regulations are cited for the exceptions, and the audit report does not show whether the auditors allowed the County a grace period for adjustment established by Federal rule with respect to erroneous payments. (Handbook of Public Assistance Administration, Section 5512, sometimes referred to as the "due diligence" rule.)

The disallowance in the Alameda County case was calculated as a flat 50% of the \$388,605 drawn from County summaries. The fact that no adjustments were made for the specific audit exceptions suggests a lack of careful analysis in the disallowance.

Lake County Audit

In the Lake County case, the agency asserted that the disallowance was based on the findings of HEW Audit Report ACN 60250-09, dated October 8, 1975. This HEW audit, however, consisted solely of a review of procedures utilized by the State to adjust for overpayments of Federal funds reported by the SCO. The HEW Audit Agency made no direct, independent review of the payments in question. The \$962.50 disallowed was taken from an SCO audit report dated April 18, 1975, covering Lake County programs under Titles IV-A, X, and XIV of the Social Security Act for the period October 1, 1971 through March 31, 1973. The amount disallowed does in the Lake County case represent the Federal share of specific audit exceptions. These exceptions are based on State standards, however, and it is not clear from the audit whether the Federal grace period for adjustment was allowed. The agency performed no testing to determine the reliability of the Lake County audit for purposes of Federal disallowance.

The Marin County Decision

Prior to the early 1970's, the State practice was to require counties to pay back all but the county share where payment errors were identified through State audits. When the State attempted, however, to audit only a small proportion of the counties' welfare cases and to project the percentage of error found to the whole of each county's caseload, the counties sued, challenging the sampling technique. Marin County v. Martin, 117 Cal. Rep. 364 (Cal. App. 1974). The State Court focused instead on the question of liability for errors in the first instance, finding that the practice of placing the entire burden on the counties was inconsistent with State statutory responsibilities for program administration. Although the Marin County decision can be read as allowing recoupment where county liability can be shown, the State claims that it was enjoined from recouping any money for erroneous payments from the counties, and the record supports a position that this was the State interpretation of the Marin County decision. HEW Audit Report ACN 60250-09 states that the State informed Lake County, by letter dated May 9, 1975, that there would be no adjustment of State claims pursuant to the Lake County audit "since all assistance expenditures within this audit are covered under the Marin County vs. Martin decision...." (p. 2.) The HEW auditors also found that a similar waiver of adjustments recommended by SCO audits had been applied to other counties and that the State considered itself unable to make the adjustments because of the Marin County v. Martin case. (p. 3.)

Under normal State procedures (consistent with an agreement between the SCO and the State Department of Benefit Payments) the auditors recommended adjustments and then the State made a determination to disallow based on the audit and on any materials presented by a county during a post-audit appeal process. These procedures were made pointless by the State's interpretation of Marin County. Since the adjustments were waived, there was no direct monetary incentive for a county to dispute the audit exceptions. According to the State, prior to the Marin County case, in a substantial number of cases a county would be able to successfully challenge the audit findings during the clearance process, usually by providing documentation not available to the auditors. The SSA has not challenged the State on this point, and, while the State's estimate that as many as 50% of the exceptions would be cleared seems high, experience with audit processes, generally, indicates that the auditors' recommendations would not have been accepted wholesale if there had been more incentive for the counties to dispute them.

Discussion

Federal Management Circular (FMC) 73-2 sets forth policies to be followed in the audit of Federal operations and programs by executive departments. With respect to reliance on non-Federal audits, FMC 73-2 provides that --

The scope of individual Federal audits will give full recognition to the non-Federal audit effort. Reports prepared by non-Federal auditors will be used in lieu of Federal audits if the reports and supporting work-papers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing standards..., and if the audits otherwise meet the requirements of the Federal agencies.

The Acting Commissioner cited FMC 73-2 as a basis for use of State audits, but SSA has argued in post-conference briefing that its failure to comply with the FMC 73-2 requirements for use of non-Federal audits does not matter here because the audits were not used as part of an agency audit plan. Although FMC 73-2 gives guidance to agencies for the efficient and coordinated development of audit plans, the provision quoted above addresses the broader situation of the use of non-Federal audits "in lieu of" Federal audits.

Under normal circumstances, the State's complaint that its own audits were unreliable might be less convincing. The State has, indeed, admitted that State audits may be a valid basis for disallowance if performed for that purpose and otherwise reliable. Here, not only is there a substantial question of reliability due to disruption of the normal audit process by the State's application of the Marin County decision, but the purpose for which the audits were relied on by the Federal agency requires that certain standards should have been met. Individual identification of erroneous payments implies identification through individual case review pursuant to audit or pursuant to inclusion in a sample for purposes of quality control, which requires review according to even stricter standards. Cf. 45 CFR 205.40. Both the Alameda and Lake County audits contain some exceptions resulting from individual case review, but there is a substantial question as to whether Federal standards, such as the "due diligence" rule of the Handbook and the Federal definition of overpayments, were applied by the State auditors. With respect to the gross figure in the Alameda County audit, pulled from County summaries (and including programs not even within the scope of the audit), there was no individual case review by the auditors.

In post-conference briefing, SSA has contended that, to succeed in its appeal, the State must meet a burden of proof of demonstrating "conclusively" the agency's error in its disallowance determination. Application of this standard is not warranted by the language of Section 201.14 and would be contrary to the policy underlying the section, however. The Section 201.14 proceedings were established to provide a means for agency reconsideration of disallowances pursuant to Section 1116(d) of the Social Security Act. Before becoming final, an initial decision to disallow should be reexamined at a sufficiently high level within the Department, through a process affording a State a meaningful opportunity to dispute the disallowance.

In general, a State must be prepared to document its claims for FFP. To ask the State provide sufficient documentation to conclusively show that the amounts disallowed here do not represent erroneous payments would be unfair, however, in light of the defective nature of the disallowance determination, particularly with respect to the figures pulled from the County summaries with no identification of relevant case files.

The State has here met its burden of going forward by introducing new relevant evidence, documentation, and argument, and SSA has responded with mere assertions that it ought to be able to depend on SCO audits, that the State should submit more documentation, and that the SCO Alameda County audit presented findings based on Federal standards. SSA places too much weight on the fact that the auditors' statement with respect to overpayments reported on County summaries is labeled a "finding" and refers to Federal standards. The State has shown that the audits were not reliable for purposes of adjustment of county claims due to the Marin County case. The State has moreover introduced documentation which raises substantial doubt that the audits otherwise provide a valid basis for determining the Federal share in individually identified erroneous payments in the programs audited.

Conclusion

The State has demonstrated that the State audits do not present a sufficient basis for findings of fact, required by Section 201.14, that the State had claimed FFP in individually identified erroneous payments in the amounts disallowed. Accordingly, as successor to the Administrator, SRS, for purposes of this review, I hereby reverse the disallowances of \$194,302.53 in the Alameda County case and \$962.50 in the Lake County case. This decision is the final administrative action in these matters.

/s/ Malcolm S. Mason, Chairman