

<h1>ACF</h1> <p>Administration for Children and Families</p>	<b>DEPARTMENT OF HEALTH, EDUCATION AND WELFARE</b> <b>Administration for Children, Youth and Families</b>	
	<b>1. Log No:</b> ASSA-AT-79- 12 (OFA)	<b>2. Issuance Date:</b> March 7, 1979
	<b>3. Originating Office:</b> SOCIAL SECURITY ADMINISTRATION	

**ACTION TRANSMITTAL**

**TO:** STATE AGENCIES ADMINISTERING APPROVED PUBLIC ASSISTANCE PLANS AND OTHER INTERESTED ORGANIZATIONS AND AGENCIES

**SUBJECT:** Fiscal Disallowance for Erroneous Payments in the Aid to Families With Dependent Children and Medicaid Programs; and Federal Fiscal Liability in the SSI Program

**REGULATION REFERENCE:** 45 CFR 205.41

**ATTACHMENT:** Final regulations for the AFDC, Medicaid, and Supplemental Security Income programs which prescribe the methods to reduce erroneous payments in these programs. State AFDC and Medicaid agencies will be subject to a disallowance of Federal matching funds if they fail to meet error rate standards for ineligibility and overpayment in AFDC and ineligibility in Medicaid. The Department will assume fiscal liability for excess ineligibility and overpayment errors made in federally-administered State Supplements in the SSI program.

The attached document contains separate regulations for each program.

**PROGRAM APPLICATION:** AFDC program. This regulation is applicable only to cases within the State's QC sample universe. SSA-AT-7816 (OFA), dated May 4, 1978, is applicable only to cases outside of the State's QC universe.

**EFFECTIVE:** March 7, 1979.

**INQUIRES TO:**

SSA Regional Commissioners.  
 Associate Commissioner for Family Assistance  
 DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE  
 SOCIAL SECURITY ADMINISTRATION  
 WASHINGTON, D. C. 20201

[Attachment](#) - CORRECTION ACTION TRANSMITTAL: SA-AT-79-28

<b>ACF</b> Administration for Children and Families	<b>DEPARTMENT OF HEALTH, EDUCATION AND WELFARE</b> <b>Administration for Children, Youth and Families</b>	
	<b>1. Log No.:</b> SA-AT-79-28 (OFA)	<b>2. Issuance Date:</b> July 23, 1979

**CORRECTION ACTION TRANSMITTAL**

**TO:** STATE AGENCIES ADMINISTERING APPROVED PUBLIC ASSISTANCE PLANS AND OTHER INTERESTED ORGANIZATIONS

**SUBJECT:** Fiscal Disallowance for Erroneous Payments in the Aid to Families With Dependent Children and Medicaid Programs; and Federal Fiscal Liability in the SSI Program

**REGULATION REFERENCE:** 45 CFR 205.41

**PURPOSE:** This transmittal corrects the PROGRAM APPLICABILITY statement issued in SSA-AT-79-12(OFA), dated March 7, 1979.

**INSTRUCTION:** The correct statement should read as follows:  
"PROGRAM APPLICABILITY: AFDC program. SSA-AT-78-16, AT-77-55, and AT-77-30 apply to all payments to ineligibles and overpayments made between March 16, 1977, and March 31, 1979, and effective April 1, 1979, apply only to payments to ineligibles and overpayments which are outside the State's QC universe. 45 CFR 205.41--Reduction of FFP for incorrect payments by States--became effective March 7, 1979. However, States will not be subject to disallowances for incorrect payments under this regulation until the period beginning April 1, 1979."

**INQUIRIES TO:** Regional Commissioners, SSA  
Barry L. Van Lare, Associate Commissioner for Family Assistance

12578 [4110-12-M] Title 20-Employees' Benefits  
CHAPTER III-SOCIAL SECURITY ADMINISTRATION, DEPARTMENT OF HEALTH,  
EDUCATION, AND WELFARE  
[Regs. No. 205 and 16]

PART 416-SUPPLEMENTAL SECURITY INCOME FOR THE AGED, BLIND, AND  
DISABLED  
Title 42-Public Health  
CHAPTER IV-HEALTH CARE FINANCING ADMINISTRATION, DEPARTMENT OF  
HEALTH, EDUCATION, AND WELFARE

PART 431-STATE-ORGANIZATION AND GENERAL ADMINISTRATION  
Title 45-Public Welfare  
CHAPTER II-OFFICE OF FAMILY ASSISTANCE (ASSISTANCE PROGRAMS),  
DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

PART 205-GENERAL ADMINISTRATION-PUBLIC ASSISTANCE PROGRAMS  
Fiscal Disallowance for Erroneous Payments in the Aid to Families With Dependent Children

and Medicaid Programs; and Federal Fiscal Liability in the Supplemental Security Income Program

**AGENCY:** Department of Health, Education, and Welfare.

**ACTION:** Policy statement on final rules.

**SUMMARY:** The regulations that follow this policy statement establish policies by which we seek to reduce erroneous payments In Aid to Families with Dependent Children (AFDC), Medicaid, and Supplemental Security Income (SSI). In particular, States will be subject to a disallowance of Federal matching funds in AFDC and Medicaid If they fall to meet error rate standards for ineligibility and overpayment in AFDC and ineligibility in Medicaid. Correspondingly, the Department of Health, Education, and Welfare will assume fiscal liability for excess ineligibility and overpayment errors made in Federally-administered State supplements in the SSI program.

**DATES:** The final rules are effective March 7, 1979.

**FOR FURTHER INFORMATION CONTACT:**

For AFDC: Sean Hurley, Division of Quality Control Management, 202-245-0788.

*For SSI:* William J. McCarthy. Division of Standards and Operating Policies, 301-594-4594.

*For Medicaid:* Victor Kugajevsky, Medicaid Bureau, 202-472-3846.

**SUPPLEMENTARY INFORMATION:** The disallowance provisions for AFDC and Medicaid are Issued under statutory authority provided in the Social Security Act. These provisions are part of a broad Federal improvement effort directed at the State operated programs. These Initiatives include technical assistance to individual States and localities, the creation of an AFDC Welfare Management Institute to facilitate the exchange of information on management practices, the recently implemented incentive provisions of the Social Security Act whereby States may share in the Federal cost savings attributable to low rates of payment error in AFDC, and proposed performance standards for accuracy, quality of service, and cost effectiveness.

We believe that these regulations are fair In that no Federal funds will be disallowed to any State meeting either an absolute standard of error or a prescribed annual rate of error reduction. The final rules set a target Improvement rate of 15.7 percent for Medicaid and 6.4 percent for AFDC. These performance targets have an empirical basis superior to that for the notice of proposed rulemaking.

While we are issuing separate regulations for AFDC and Medicaid, the disallowance provisions of the two programs share the following components:

- To avoid a disallowance, each State must meet either a national standard for percent of payments In error or a prescribed rate of reduction In the percent of payments in error.
- The national standard for error rate performance in any period is the national weighted mean payment error rate calculated for a prior specified base period.
- States will first be subject to disallowances for errors in the period April-September 1979. The national standard for this and the next period (October 1979-March 1980) will be

established with respect to an initial base period (which differs between the two programs). Subsequently, national results from each April-September reporting period will be used to calculate the national standard in each program for the second and third subsequent six-month periods.

- The target rate of improvement for States unable to meet the national standard is based upon the historical experience in AFDC quality control.
- Errors which are attributed to client causes and those which are "technical" in nature (i.e., would not have affected the eligibility or benefit determination, if corrected) will be included in the measurement of error for purposes of judging compliance with these regulations. To do otherwise would create inappropriate incentives to the States as to the attribution of error and would undermine the intent of program eligibility and benefit provisions.
- Not included in the measurement of error will be underpayments to eligibles and negative case action errors. The appeals and fair hearings process, and recently implemented incentive payments, and the quality control system are all directed at underpayment and negative case action errors, as well as ineligibility and overpayment errors. Available evidence does not suggest that underpayments and incorrect denials and terminations increase as overpayment and ineligibility errors are reduced. On the contrary, a recent review found that quality control has reduced all categories of error.
- The amount of fiscal disallowance for any period will be the difference between (a) Federal matching funds for benefits actually paid and (b) Federal matching funds for benefits that would have been paid, had the State met either the national standard or the target rate of improvement (whichever requires less error reduction).
- States may be exempted from disallowances if they can establish good reason for not meeting their error target.
- States who wish to appeal a proposed disallowance may do so through the Grant Appeals Board, under procedures established in the Social Security Act.
- We are undertaking an 18-month study to determine a reasonable ultimate goal for error rates in each program. There is some point at which further error reductions are not cost effective. We do not believe that the national mean error rate will reach such a point in the coming two years, but we anticipate that subsequent policy must be based on an informed judgment as to the cost effectiveness of further corrective action.
- In two years, we will review these regulations to determine whether to revise either the expected improvement rate, on the basis of more recent quality control data, or the definition of the national standard, on the basis of the findings of the 18-month study.
- We do not feel that these regulations have sufficient economic impact to warrant a regulatory analysis as required by Executive Order 12044.

Beyond these common components, the regulations for AFDC and Medicaid differ in the following respects:

- The rate of improvement expected of States unable to meet the national standard is 6.4 percent for AFDC and 15.7 percent for Medicaid. Both figures are drawn from the historical experience in AFDC. The improvement rate employed in the AFDC regulation

is the national trend rate of reduction in the sum of ineligibility and overpayment errors between January-June 1976 and July-December 1977. This recent period establishes a more reasonable expectation of future error reduction than the interval April-September 1973 to July-December 1976, which was used to calculate the 18 percent improvement rate in the notice of proposed rulemaking. The Medicaid improvement rate corresponds to the reduction in AFDC eligibility error between April-September 1973 and January-June 1975. This earlier period is used to reflect our expectation that the more recent implementation of quality control in Medicaid will lead to error reductions of the magnitude achieved in AFDC over a comparable earlier period.

- The initial base period, used to calculate a national standard for the April-September 1979 period will be April-September 1978 in AFDC and July-December 1978 in Medicaid. This difference is due to recent changes in the Medicaid quality control program and the inability to immediately implement in April-September, October-March reporting cycle. Beginning with the period April-September 1980, disallowances in both programs for subsequent six-month periods will be based on a national standard corresponding to the April-September period occurring either two or three periods earlier.
- If a State is unable to provide a sample estimate of its error rate in Medicaid for any six-month period, we will assign an error rate to the State on the basis of the best information available to us. This will be necessary not only to judge compliance with the regulation but also to enable the national standard to be calculated on the basis of performance. In a The provisions related to SSI will protect States against fiscal liability for excessive errors made by the Social Security Administration in administering State supplements. The national standard will be 4.85 percent for April-September 1979 and 4.0 percent thereafter. States will be reimbursed for their share of any benefits paid in excess of these standards.

Dated: February 21, 1979.

JOSEPH A. CALIFANO, Jr., Secretary.

[FR Doc. 79-6786 Filed 3-6-79; 8:45 am]

[4110-07-M] Title 20-Employee's Benefits

CHAPTER III-SOCIAL SECURITY ADMINISTRATION, DEPARTMENT OF HEALTH,  
EDUCATION AND WELFARE

[Regs. No. 205 and 16]

PART 416-SUPPLEMENTAL SECURITY INCOME FOR THE AGED, BLIND, AND  
DISABLED

Subpart T-State Supplementation Provisions: Agreements; Payments

QUALITY ASSURANCE SYSTEM-PERFORMANCE STANDARD FOR FEDERAL  
ADMINISTRATION OF STATE SUPPLEMENTAL PAYMENTS FOR SUPPLEMENTAL  
SECURITY INCOME-FEDERAL FISCAL LIABILITY WHEN ERROR RATES EXCEED  
THE NATIONAL STANDARD

Title 45-Public Welfare

CHAPTER II-OFFICE OF FAMILY ASSISTANCE (ASSISTANCE PROGRAMS),  
DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

PART 205-GENERAL ADMINISTRATION-PUBLIC ASSISTANCE PROGRAMS  
Quality Control System-Performance Standard for Aid to Families with Dependent Children (AFDC). Payments-Reduction In Federal Financial Participation (FFP) When Error Rates Exceed the National Standard

**AGENCY:** Social Security Administration.

**ACTION:** Final rule.

**SUMMARY:** These regulations provide the rules, we will use in the Aid to Families with Dependent Children(AFDC) program to reduce our Federal matching payments (FFP) to States which make incorrect AFDC payments that exceed a prescribed rate. The prescribed rate for each State will be the national standard or the State's target error rate, whichever is higher. The national standard will be the weighted mean payment error rate for all States. Data from the State Quality Control (QC) system and the Federal review monitoring system will be used to develop the payment error rate for each State. A State's target error rate will be figured by multiplying its base period payment error rate by 93.6 percent. (This figure is 100 percent minus the 6.4 percent national Improvement rate.)

These regulations also provide that States failing to meet the prescribed rate may have 65 days to show there was good reason for not meeting the rate and thus avoid reduction in the matching funds. The State may also appeal the reduction under the usual section 1116(d) procedures.

These regulations also provide the rules we will use in the Supplemental Security Income (SSI) program to determine how much money we will need to pay back (Federal fiscal liability) to a State where we have agreed with a State to make both the mandatory and the optional State supplementary SSI payments. Basically, we will pay back to a State the total amount of incorrect payments we make above the goals established in these regulations. The goal is a 4.85 percent payment error rate for April-September 1979 and 4 percent beginning in October 1979. We will reduce the amount of money we must pay back by the amount of money we recover (recoup) from beneficiaries who have been overpaid or who have received payments even though they were ineligible.

We use the data from our SSI Quality Assurance system to develop our payment error rate in each State. A State may review a sample of the cases in our SSI quality assurance system, just as we may review a sample of cases from a State's AFDC quality control system.

**EFFECTIVE DATE:** March 7, 1979.

**FOR FURTHER INFORMATION CONTACT:**

For AFDC: Sean Hurley, Division of Quality Control Management,202-245-0788.

For SSI:William J. McCarthy, Division of Standards and Operating Policies, 301-594-4594.

**SUPPLEMENTARY INFORMATION:**

INTRODUCTION

We and the States are committed to reducing incorrect payments in both the AFDC and SSI programs, and we believe that improved management of these programs will increase public

confidence in them. We intend to devote considerable resources to improving these programs. At the same time, we believe it is necessary to be able to impose some reduction in Federal funding for States which do not improve at an acceptable level and to impose sanctions against ourselves if we fail to achieve an acceptable level of performance in administering State supplementary payments for the SSI program.

In recent years, errors have decreased in the Aid to Families with Dependent Children (AFDC) program from 16.5 percent of all payments in 1973 to 8.7 percent in 1977, and in the Supplemental Security Income (SSI) program from 11.5 percent in 1975 to 4.6 percent in 1977. Since the rate of the decline in error rates has slowed recently, these regulations will encourage States (for AFDC) and us (for SSI) to continue to reduce the payment error rates. We will continue to use the quality control systems to produce the error rate data required, and to provide information to help reduce the incorrect payments.

### **AFDC: HISTORY**

In 1973, we published a regulation which permitted us to reduce our Federal matching funds to a State if the case error rate for ineligibility was more than 3 percent and if the overpayment case error rate was more than 5 percent. In 1976, the U.S. District Court for the District of Columbia ruled in *Maryland v. Mathews* (415F.Supp. 1206, D. D.C., 1976) that the 3 percent and 5 percent error rate levels were "arbitrary" and "capricious" and that we could not reduce matching funds based on these levels in the 14 States involved in the litigation. We decided not to reduce matching funds in any State and withdrew our regulation.

After that court decision, we discussed the quality control program, error rate goals and funding disallowances and policies extensively with State and local governments and their representative organizations. We then published an NPRM on July 7, 1978, which provided our proposed rules. We have modified some of those rules in these final regulations based on comments we received.

### **AFDC: THE RULES**

In these rules, we establish a national standard for incorrect payments in the AFDC program. We establish this national standard every year using the payment error rate data from the April-September quality control system period. The national standard will be a weighted mean of all of the States' payment error rates. This standard will be used to measure performance of the States in the following April-September period and in the October-March period after that. A State whose payment error rate is below the national standard must not go above the standard, without risking reduction in Federal matching funds. A State whose payment error rate is above the standard must reduce its error rate to the national standard or to the State's target error rate established under these rules. To figure the target error rate, we have established 6.4 percent as a reasonable rate of improvement in a State's performance that is above the national standard. We, therefore, will establish the target error rate by multiplying the State's payment error rate by 93.6 percent. (This figure is 100 percent minus the 6.4 percent national improvement.)

### **AFDC: MAJOR DIFFERENCES BETWEEN NPRM AND FINAL REGULATION**

In the NPRM, we proposed that the national standard for AFDC be the 50th percentile (median)

of the payment error rate for all States. Based on comments we received, we are using the weighted mean payment error rate for the national standard in these final regulations.

In addition we have lowered the national improvement rate from 18 percent of the State's full payment error rate to 6.4 percent. The national improvement rate will stay unchanged for the 2-year period April 1979 to April 1981 instead of being adjusted annually as was proposed in the NPRM. We will evaluate the improvement rate at that time.

We have also rewritten these regulations in simpler and clearer language. We are not publishing these regulations as joint regulations with the Health Care Financing Administration which is responsible for the Medicaid program. We combined the proposed rules in the NPRM because we were proposing common policies and we wished to receive integrated comments.

### **AFDC: RESPONSE TO PUBLIC COMMENTS**

The Notice of Proposed Rulemaking was published In the Federal Register on July 7, 1978 (43 FR 29311). Comments were received from 45 State and local welfare departments, 29 legal aid organizations, 16 private individuals, and other public or private organizations. The significant comments and our response follow.

### **APPROPRIATENESS OF FISCAL DISALLOWANCE (REDUCTION) POLICY**

**Comment:** Most States were against any fiscal disallowance (reduction) policy. Their reasons ranged from the belief that reductions would reduce resources available for corrective action, to our not having the legal authority to impose fiscal reductions. Some States suggested that we have incentive provisions instead of fiscal disallowances.

**Response:** Our authority to issue regulations for reducing Federal financial participation for incorrect payments made by States is contained in sections 403 and 1102 of the Social Security Act. That authority was implicitly upheld in the U.S. District Court decisions in the case of *Maryland v. Mathews* (415 F. Supp. 1206, D. D.C., 1976). We have, however, no authority to provide incentive payments to encourage reduction in the amount of incorrect payments beyond those provided in section 403(j) of the Social Security Act. This section provides for payments to States if their payment error rate (including payments to ineligible, overpayments, under payments, and incorrect terminations and denials) is 4 percent or below. At the same time, we believe that a national standard for performance, a national improvement rate and appropriate reductions in Federal matching funds to States which fail to meet their target error rates are necessary to encourage and maintain the States' commitment to reducing the amount of incorrect payments in the AFDC program.

### **MEAN VS. MEDIAN NATIONAL ERROR RATE**

**Comment:** Many States said that the national mean (weighted average of State payment error rates) would be a more reasonable standard than the national median proposed in the NPRM. This was based on the belief that States with the largest caseload and expenditures should have a proportionally greater influence on the performance standard than States with smaller caseloads and expenditures.

**Response:** We have accepted this suggestion and the final regulation provides for using the weighted mean as the national standard. For the July-December 1977 AFDC period the national median, as used in the NPRM was 7.0 percent, and was met by 25 States; in the same period, the national mean, as used in the final regulation, was 8.7 percent and was met by 36 States.

## **INDIVIDUAL STATE PERFORMANCE STANDARD**

**Comment:** Some States expressed the opinion that a national performance standard was unreasonable because of the wide variation among the States in terms of the complexity of their programs and caseloads. They proposed that individual State performance standards be established.

**Response:** We do not believe individual performance standards are desirable for several reasons:

1. It is not administratively feasible to have individual performance standards.
2. Analyses have shown that there is no pattern of statistical correlation between any given individual variable and high or low error rates.
3. Beyond the basic Federal requirements, States have considerable latitude in deciding what kind of program rules and procedures they wish to have.
4. We have to monitor all programs in the same way to be equitable.

Therefore, we will retain a national standard. Changing this standard from the median to the mean, however, means that about two-thirds of the States are already achieving the standard. Also, we provide that States with error rates above the national standard may avoid reductions in Federal matching funds if they achieve individual target rates that show reasonable progress toward the standard.

## **THE 18-PERCENT ANNUAL NATIONAL HISTORICAL AVERAGE RATE OF IMPROVEMENT**

**Comment:** The States and others objected to the use of an 18 percent national historical improvement rate for two basic reasons: (1) QC data were used from the first 2 years (1973-1975) even though improvements from the least costly corrective actions and elimination of the most easily corrected errors were included in that period, and data from the latest QC period were not included; and (2) future corrective actions will cost more than the dollars saved as error rates get lower.

**Response:** We believe that a State whose error rate is above the national standard should reduce its payment errors at a reasonable rate to the national standard. However, we agree that the States make a good point and we have decided not to use the earlier QC data in determining the national improvement rate. We will use more recent data from January 1976 through December 1977. Using only these data lowers the national improvement rate from 18 percent to 6.4 percent.

We believe that in those States with AFDC error rates above the national standard, a 6.4 percent improvement rate is a reasonable expectation in light of the degree of error in those States and the historical nationwide experience in reducing error in the AFDC program.

We believe it is reasonable to hold the 6.4 percent improvement rate for 2 years. This rate may be higher or lower than would have resulted from the provision in the NPRM which allowed for calculating a new improvement rate after every base period. However, we believe that a constant rate will inform States with high error rates how much they must improve, and we must expect at least this degree of improvement annually over the next 2 years. After 2 years we will reexamine this standard.

We do not believe that States above the national standard are in the position that the only effective corrective actions are too costly. Several studies have shown that many corrective actions which result in high error reductions do not require significant allocations of resources.

### **COUNTING PROCEDURAL ELIGIBILITY AND RECIPIENT ERRORS**

**Comment:** Some respondents objected to including procedural errors like the absence of WIN registration or social security number as part of the payment error rates. They argue that these errors do not mean a savings when the error is corrected, and therefore, they should not be included in the reduction calculation.

**Response:** We will include in the payment error rate errors like the absence of WIN registration or social security number. These are basic statutory eligibility requirements and we must ensure that all eligibility requirements are met. We must therefore measure all eligibility requirements.

### **AGENCY ERROR ONLY SHOULD BE COUNTED**

**Comment:** Some commenters suggested that only agency errors, not those caused by beneficiaries, should be counted in determining the payment error rate.

**Response:** We believe that some beneficiary errors are controllable as shown by the 51.6 percent reduction in these errors since 1973. If we did not include these errors in the payment error rate, the States would not have as great an incentive to develop systems that are responsive to nonreporting and incorrect reporting errors. It would also build into the quality control system a potential bias because States might attribute more errors to the recipient than should be.

### **INCLUSION OF INCORRECT NEGATIVE CASE ACTION AND UNDERPAYMENT RATES**

**Comment:** Some commenters suggested that negative case actions and underpayment error rates be included in calculating a State's payment error rate. Their concern is that the emphasis on reducing overpayments and payments to ineligibles will increase the number of incorrect denials or terminations and the number of underpayments. Recipient groups were also concerned that the emphasis on reducing incorrect payments would cause the States to impose unreasonable verification requirements on applicants and beneficiaries.

**Response:** Available evidence indicates that causes of errors affect ineligible cases, overpayments, underpayments, denials and terminations alike. Therefore, addressing causes of the error often reduces both overpayments and underpayments. Furthermore, in addition to the appeals and hearing process, which is designed to protect beneficiaries from the excesses suggested, section 403(j) of the Social Security Act provides for incentive payments to States which have low error rates; these error rates include underpayments, denials and terminations.

We will, however, continue to monitor the negative case action and underpayment results. We will also examine ways to establish incentives for reductions in negative case errors and other means to achieve lower negative case error rates. However, because this regulation is grounded on the disallowance of incorrect expenditures of funds and because a negative case action does not result in an incorrect expenditure, we have not included any method for taking a disallowance based on negative case actions.

#### **THE 4 PERCENT GOAL**

**Comment:** Some States commented that the 4 percent goal for AFDC error rates had no empirical basis and should not be established until after the completion of our planned 18-month study. Several stated that an ultimate performance goal should be the limit under which no reduction in payment errors would be cost effective, and that a hold harmless tolerance above the ultimate goal should be provided.

**Response:** The 4 percent goal corresponds to, but is more narrowly based than, the error rate level which States must achieve in AFDC to qualify for incentive payments recently authorized by Congress (section 403(j) of the Social Security Act as amended by section 402 of Pub. L. 95-216). The fact that 9 States are now at or below this goal shows that it is attainable. However, we are not requiring any State to reduce its payment error rate to 4 percent. We are only requiring a State to improve to the national standard or to the State's target error rate, whichever is higher, or remain below the national standard.

We are going to do a study to determine a reasonable goal. If the results of that study, indicate that the ultimate performance goal should be higher than 4 percent, we will set a new goal. In the meantime, the final regulations do not include any reference to the 4 percent goal.

#### **THE \$5 DISREGARD**

**Comment:** Several States objected to the \$5 disregard before we would count an incorrect payment as an error. The States contended that by disregarding incorrect payment of less than \$5, we would overlook incorrect payments of more than 6 percent of the average benefit level in States with the smallest benefit level, while overlooking incorrect payments of only 1 percent of the average benefit level in States with the highest benefit level.

**Response:** While this ratio will always exist between larger and smaller payment States as long as there is an individual case dollar tolerance, the impact of this tolerance on individual State payment error rates or the national mean will be negligible. We do not believe we should distort the analysis of case or payment error rates with insignificant error amounts. Therefore we will retain the \$5 case tolerance.

#### **ERROR RATES ASSOCIATED WITH TIME SPENT ON REVIEW**

**Comment:** States commented that the time spent on quality control reviews varied widely from State to State and suggested that the quality of the review varied accordingly. The States also suggested that variation existed in the Federal rereview of the State's quality control systems.

**Response:** We agree that the quality control review can vary due to State program differences. Based on the data collected, however, there does not appear to be any statistical correlation

between the time spent, the quality of the case review, and high and low error rates in States. The Federal review mechanism can also vary if not monitored closely; we will strengthen this function.

### **CHANGE TIME FRAME OF IMPLEMENTATION**

**Comment:** States expressed concern that more lead time was necessary to secure legislative change and budget authorizations for corrective action initiatives. They suggested that no reductions in Federal matching be applied until the third or fourth periods after the base period. They also suggested that a base period after September 1978 should be used because the final regulations would not be published until after the end of the April-September 1978 period.

**Response:** The corrective action process is a continuous one and the basic causes of incorrect payments have not changed significantly. States, therefore, now have sufficient data to start on appropriate corrective actions. Furthermore, studies have shown that some significant corrective action projects have been and can be implemented without major allocation of new resources. Also, the States should find it easier to meet the prescribed rate because of the changes we have made in the final regulations-most specifically using the weighted mean payment error rate for the national standard, and lower national improvement rate. We believe that the time frames proposed are reasonable, and therefore, we have made no change.

### **COMPLIANCE WITH EXECUTIVE ORDER 12044**

**Comment:** Several commenters said that the proposed regulations should have followed the Executive Order more closely. The order provides that proposed regulations that will have major economic consequences must be accompanied by a detailed regulatory analysis which includes an examination of alternatives considered.

**Response:** These regulations will not result in the level of economic impact which requires a regulatory analysis. We believe, moreover, that the NPRM did indicate the main issues involved in the proposed policies. Some of these were:

1. The use of a national standard vs. individual State standards;
2. The reduction of error rates in stages vs. immediate application of a standard;
3. The use of the payment error rate vs. the case error rate;
4. Reasonable progress toward a goal based on an historical improvement rate vs. another rate; and
5. Whether there should be "good cause" exceptions for failure to meet the prescribed error rate.

A number of States and others responded to the issues in the NPRM; this would indicate that the alternatives were presented in sufficient detail.

### **OFFSET OF DEDUCTION BY RECOUPMENT**

**Comment:** Several States thought we should consider reducing the reduction of Federal matching funds by the amounts States recovered from overpaid or ineligible beneficiaries.

**Response:** We will consider this in more depth and are open to suggestions from States and others on how such a policy could become a part of the reduction calculation. Since no reductions in Federal matching will occur for more than a year, we can amend the regulations later if we decide to include this policy.

## **APPEALS PROCEDURES**

**Comment:** Several States commented that the final regulations should describe the appeals process in more detail and that the "good cause" exceptions should be broader.

**Response:** The final rule retains the provisions regarding good cause exceptions. We disagreed with the general statements that the factors given as examples should be broadened. Because a State's failure to act upon legislative changes or to obtain budget authorization is within State control. In our view it does not justify a State's failure to administer the SSI or AFDC program effectively and to meet error reduction goals.

The Secretary's decision on whether the State's failure to meet its target was due, in whole or part, to factors beyond its control necessarily requires a judgmental weighing and balancing of many considerations. We have not established a formal administrative process for the Secretary's review of the State's good cause request. We believe this process must necessarily be informal, permitting a free interchange between the Secretary and the State, and allowing the Secretary to consider all the pertinent facts and circumstances. However, we have added a provision specifying that a final disallowance by the Secretary is subject to reconsideration within 45 days from the date of our notice. The regular procedures for appeal of disallowances will apply, including review by the Grant Appeals Board (see 45 CFR Part 416).

## **SSI: HISTORY AND RULES**

Since January 1975, under our agreements with the States we have accepted Federal fiscal liability (FFL) for our incorrect payments of mandatory and optional State supplementary payments that we make for the States. We have used the case, rather than payment, error rates to determine our FFL. In these regulations, we are changing to using the payment error rate as the basis for determining the amount of our liability.

We will pay back to a State the total amount of the monies we misspend on its behalf, minus the amount we recover from beneficiaries, that exceed the payment error rate standard. This standard is 4.85 percent for the April-September 1979 period. This is midway between the current tolerance level of 8 percent case error rate (5 percent overpayments and 3 percent ineligibles) which equals a 5.7 percent payment error rate and an ultimate 4 percent performance standard. The 4 percent standard will be effective beginning October 1979.

## **SSI: RESPONSE TO COMMENTS LACK OF STATE ROLE IN SETTING STANDARDS**

**Comment:** Some commenters said that States are not given a role in setting the standards for the mechanism used in determining and calculating Federal fiscal liability.

**Response:** The current system does provide sufficient means for resolving differences between SSA and the States in determining the payment error rates. The rules for FFL determinations

have been shared with the States. In addition, the States have had an opportunity to see the mechanism in action through the sub-sample review available under the Federal State agreements. We will continue to discuss significant changes in the SSI QA system and will continue to meet with interested groups or representatives from States about the SSI QA system.

### **STATE REVIEW OF SAMPLE CASES**

**Comment:** Some commenters said the States are not given the opportunity to perform a review of a sample of the cases reviewed by the Social Security Administration in calculating the error rates.

**Response:** Current Federal-State agreements explicitly provide the States with the right to review the QA system sample findings. States have the right under the agreements to exercise this option, although some States have chosen not to do so. If a State reviews the QA findings and the Social Security Administration agrees with the State's review findings, the Quality Assurance data base is revised to reflect the corrections. This provision is being added to the regulations to emphasize the Department's commitment to this policy (see new 416.2086(h)).

### **EFFECT OF STATE SAMPLE REVIEW**

**Comment:** Some commenters expressed concern that the States' subsample results have no effect on calculations of the final error rates.

**Response:** If a State chooses to review a sample of QA cases, we have a process for settling disagreements that may arise between the State and us as a result of the reviews. When we resolve the disagreement and if the State findings are correct, we change the QA data base to reflect the State's findings. Thus, the State's subsample results do have an effect on the calculation of the final SSI error rates.

**Comment:** A comment was made that there are no requirements that SSA's reviews be completed, results reported, and corrective action taken on a timely basis.

**Response:** The current system provides for the timely completion of SSA's reviews, the reporting of results and timely corrective action. Data relating to determination of Federal fiscal liability and adjustment of accounts are currently on a timely basis. For example, the October 1977 to March 1978 SSI data were recently reported at the point when the July to December 1977 AFDC data were released. Generally the SSI Quality Assurance results are on a tighter release schedule than AFDC results. The current data analysed and corrective actions are effective as shown by the significant reductions in payment error rates over a relatively short time frame. The Social Security Administration will continue to meet the current tight completion goals and will accept the completion requirements placed on the States.

### **STATE'S RIGHT TO AUDIT**

**Comment:** One commenter said that the regulations are silent on the States' right to audit. This audit right should be explicit within the regulations.

**Response:** Current Federal-State agreements, developed with the States, provide for the States' right to audit SSA's payment of State supplementary payments. We do not believe this regulation is the appropriate place for rules about a State's audit rights.

## **REVIEW QA SYSTEM**

**Comment:** Some States also indicated that they should be able to audit or rereview the SSI QA system and its findings.

**Response:** We include rereview procedures in these regulations. In addition, SSA is committed to informing the States of plans for significant changes in the system and will consider their views before implementing any changes. SSA has and will continue to discuss with the States matters of mutual concern affecting the QA system.

## **ELIMINATION OF FFL**

**Comment:** Some commenters question the elimination of Federal fiscal liability for States which have only Federally administered mandatory supplements. There are no Federally administered optional supplements in these States.

**Response:** Federal administration and liability for the mandatory supplementation only States has continually declined. In most of these States there was no FFL in the past year. For those States in which the potential for liability still exists, the Federal payment would be a very small percentage of the actual cost of doing a QA sample. The cost to continue sampling for Federal fiscal liability for mandatory supplement only States is, therefore, prohibitive.

(Secs. 1102 and 1631 of the Social Security Act, as amended; 49 Stat. 647, as amended, 86 Stat. 1745, as amended; 42 U.S.C. 1302 and 1383.)

(Catalog of Federal Domestic Assistance Program Nos. 13.807, Supplemental Security Income Program; 13.808, Assistance Payments-Maintenance Assistance (State Aid).)

Dated: February 14, 1979.

STANFORD G. ROSS, Commissioner of Social Security.

Approved: February 21, 1979.

JOSEPH A. CALIFANO, Jr., Secretary of Health, Education, and Welfare.

1. 20 CFR Part 416 is amended by adding a new 416.2086 to read as follows:

416.2086 Federal liability when error rate in payment of Federally administered State supplementation exceeds national standard.

- a. Purpose. This section provides the rules we will use to determine the amount of our liability (Federal fiscal liability or FFL) when our incorrect supplementary payments have exceeded an established level. If we have agreed with a State to handle both its optional and its mandatory supplementary payments, we will reimburse the State when our error rate exceeds the national standard.

- b. Definitions. For purposes of this section "National standard" refers to a combined dollar error rate of overpayments and payments to ineligible individuals which we must not exceed if we are to avoid FFL. The standard is 4.85 percent for the period April 1979 through September 1979, and 4 percent beginning October 1, 1979.

"Overpayment" refers to the amount by which a Federally administered State supplementary payment to an eligible individual for a specified month exceeds the amount the individual should have received for the month. An overpayment must be \$5 or more to be included in the payment error rate. Overpayments exclude cases involving a payment adjustment lag.

"Payment to an ineligible individual" refers to any Federally administered State supplementary payment to an individual who was ineligible to receive any amount of either a Federally administered State supplementary payment or a Federal supplemental security income payment for the month. Payments to an ineligible individual exclude cases involving a payment adjustment lag.

"Payment adjustment lag" refers to a situation which results in an incorrect payment because a beneficiary's circumstances changed in the month before the month of payment, the month of payment, or a later month in the quarter during which we paid the beneficiary. However, if we try to correct the error during this period, and we make an error in changing the payment, that payment is included in the payment error rate.

"We," "us," and "our" refers to the Department or the Social Security Administration as appropriate.

- c. Applicability.
1. This section applies to States that have entered into an agreement with the Secretary of Health, Education, and Welfare for Federal Administration of both mandatory and optional supplementary payments.
  2. This section will apply to 6 month periods beginning April 1979.
  3. For States that enter agreements for Federal administration of both mandatory and optional supplementary payments after April 1979, this section will apply beginning with the first 6-month period, starting in April or October, throughout which the agreement is in effect.
  4. This section will apply to a 6 month period only if the agreement is in effect for every month of the period.
- d. Assumption of liability. When our error rate in the administration of State supplementary payments for a 6 month period exceeds the national standard, we will be liable to the State for the total amount by which the national standard is exceeded, less the total overpayments and payments to ineligible individuals that we recover.
- e. Determination of liability. In every State in which we administer both mandatory and optional supplementary payments, we will select and review a valid sample of cases of Federally administered State payments for each 6-month period beginning in April or October. We shall determine the payment error rate of Federally administered State supplementary payments for each of these States. We will assume fiscal liability for all incorrect payments which exceed a 4.85 percent payment error rate for the period from

April to September 1979 and a 4 percent payment error rate for periods after that. We will compute our liability as follows:

1. Determine the sum of the Federally administered State supplementary dollars incorrectly paid as overpayments and payments to ineligible individuals for all sampled individuals in the State for the 6-month period; and
  2. Divide the amount determined in paragraph (e)(1) by the total number of dollars paid as federally administered State supplementary payments to all sampled individuals in the State for the 6-month period; and
  3. If the quotient determined in paragraph (e)(2) does not exceed 0.0485 (4.85 percent) for the 6-month period beginning April 1979, and 0.04 (4 percent) thereafter, the national standard will not have been exceeded and the Secretary shall incur no liability to the State for incorrect payments of State supplementary payments for the 6-month period.
  4. If the quotient determined in paragraph (e)(2) of this section exceeds 0.0485 (4.85 percent) for the 6 month period beginning April 1979, and 0.04 (4 percent) after that
    - (i) Multiply the quotient so determined by the total number of dollars expended as federally administered State supplementary payments to all beneficiaries in the State for the 6 month period;
    - (ii) Multiply the total number of dollars expended as federally administered State supplementary payments to all beneficiaries in the State for the 6-month period by 0.0485 (4.85 percent) for the 6-month period beginning April 1979, and 0.04 (4 percent) after that, and
    - (iii) Subtract the product obtained in clause (ii) from the product obtained in clause (i). The difference is the Federal fiscal liability to the State for incorrect payments of federally administered State supplementary payments for the 6-month period.
- f. Recovery adjustment. We shall try to recover our overpayments and payments to ineligible individuals. We shall reduce our liability to a State under paragraph (e) to the extent that we recover incorrect payments. We will determine the amount of our reduced liability by multiplying the amount recovered by the percentage of incorrect payment to which FFL applies and subtracting the product from the FFL.
- EXAMPLE.-Total incorrect payments are \$10 million and we determine our liability to be \$1 million. We recovered \$100,000. FFL applies to 10 percent (1 million/10 million) of the incorrect payments. Ten percent of the \$100,000 we recovered is \$10,000, which we subtract from the \$1 million FFL to determine that our reduced liability is \$990,000.
- g. Exclusion from liability to "hold harmless States". If we find that we are liable under this section to a State which also receives Federal participation under the hold-harmless provision of § 416.2080, we will reduce our liability payments under this section by the amount necessary to avoid duplicate payment of Federal funds.
  - h. State review.

1. Sample selection and review. Each State may select for its own review a subsample of the cases we select for our review. The State must coordinate its review with our review of the same cases and must conduct its review at the same time as ours. We will cooperate with the State in arriving at the time for reviewing our respective samples. The States must use the same operational and program policies and procedures we use in our review. All reviews performed by a State shall be entirely at State expense.
2. Adjustment to liability. If a State's finding in a case differs from ours and if we agree that the State's finding is correct, we will revise our data base to include the State's findings. We will then determine our liability by treating the State's findings on cases that we agree upon as if they were the findings of our sample review.

2. 45 CFR Part 205 is amended by adding a new § 205.41 to read as follows:

205.41 Reduction of FFP for incorrect payments by States.

- a. Purpose.
  1. This section provides the rules we will use to determine whether we will reduce the amount of Federal matching funds (Federal financial participation or FFP) we give to a State, and, if so, the amount of the reduction. Basically, we will reduce the amount of our matching funds if a State makes more incorrect payments in its AFDC program than allowed under the rules in this section. These rules apply to all States which have AFDC programs.
  2. We will use the data from the quality control system (see.205.40) in each State and the Federal monitoring system in determining the amount of incorrect payments. The quality control system provides data on incorrect payments for every 6-month period.
- b. Definitions. For purposes of this section "Base period" refers to the April-September quality control system review period each year, beginning with the April-September 1978 period.

"Incorrect payments" refer to payments to people who are ineligible for a payment and overpayments to eligible people.

"National standard" refers to the weighted mean payment error rate of all of the States' payment error rates. "Payment error rate" refers to the dollar amount of incorrect payments a State has made expressed as a percentage of the State's total payments.

"We," "us" or "our" refers to the Department or the Social Security Administration as appropriate.

- c. General. In these rules we are establishing a national standard for incorrect payments in the AFDC programs. We establish this national standard every year using the payment error rate data from the April-September quality control system period. The national standard will be the weighted mean of all of the States' payment error rates. This standard will be used to measure performance of the States in the following April-September period and in the October-March period after that. A State whose payment error rate is

below the national standard must not go above the standard, without risking reduction in Federal matching funds. A State whose payment error rate is above the standard must reduce its error rate to the national standard or to the State's target error rate established under these rules. To figure the target error rate, we have established 6.4 percent as a reasonable rate of improvement in a State's performance that is above the national standard.

We, therefore, will establish the target error rate by multiplying the State's payment error rate by 93.6 percent. This figure is 100 percent minus the 6.4 percent improvement rate. If a State make incorrect payments in a base period that are higher than the national standard, we will give the State until the second 6-month period after the base period to reduce its incorrect payments to an acceptable level. If a State fails to meet this level during the second or third 6-month period after the base period and cannot show good reason, we will reduce the amount of our matching funds for that 6-month period(s). We provide several examples of what we will consider good reasons for not meeting the goal. We describe this process in detail in the following paragraphs.

- d. How we establish a national standard.
  1. Information we will use. We will use the information provided by the Federal/State quality control system. This system measures the dollar amount of incorrect payments for every 6-month period (April-September and October-March).
  2. How we use the information. We will figure the weighted mean payment error rate for all States using each State's payment error rate and giving weight to the total amount of payments in the State's AFDC program. The weighted mean payment error rate will be the national standard.
  3. When we will establish the national standard. We will establish the national standard every year, using the quality control data for the April-September period of each year. We refer to this period as the "base period." We will establish the national standard for this time using the quality control data from the April-September 1978 period.
- e. How we establish acceptable levels for State performance using the national standard.
  1. General. We will measure each State's payment error rate for each base period against the national standard, and set performance goals which apply to both the second and third subsequent 6 month periods. If the State's payment error rate in the base period is below the standard, we consider that the State has reached an acceptable level of performance, and the State's payment error rate must continue to remain below the standard. If the State's payment error rate in the base period is higher than the standard, the State must achieve the standard. Alternatively, if it is to the State's advantage, the State must achieve its target error rate.
  2. How we establish a target error rate for a State above the standard. We have established 6.4 percent as a reasonable rate of improvement in the performance of a State with a payment error rate above the current national standard. To establish the target error rate, we multiply the State's payment error rate in the base period by 93.6 percent (100 percent minus the 6.4 percent improvement rate).

EXAMPLE.-The State's payment error rate in the base period is 20 percent. The

national standard is 3 percent. To find the target error rate, we multiply 20 percent by 93.6 percent, which gives a target error rate of 18.7 percent.

3. When a State must meet and maintain the established rate. A State must meet the higher of the national standard or its target error rate in the second 6-month period and in the third 6-month period following each base period. Therefore, if a State has a payment error rate above the national standard for the April-September period. The State must reduce its error rate to the national standard or to the State's target error rate by the next April-September period, and also must not exceed this error rate level in the following October-March period.
- f. If a State fails to meet the established rate. If a State does not meet the national standard or its target error rate for either of the required 6 month periods and cannot show a good reason for it, we will reduce our matching funds to the State for those 6 (12) months, using the following formula. We will reduce our matching funds by the amount we would not have paid if the State had reached its goal (the national standard or the target error rate).

EXAMPLE.-If the State's target error rate was 10 percent and the State's actual payment error rate was 12 percent, we will reduce our matching funds by 2 percent of the Federal share of the dollars the State paid under its AFDC program.

- g. How a State can show good reason for not meeting the established rate.
1. We will notify a State that we are going to reduce (or disallow) matching funds because the State did not meet the national standard or the target error rate established for the State. The State will have 65 days from the date on this notification to show good reason for not meeting the established error rate. If we find that the State did not meet the standard or the target error rate because of factors beyond its control, we will reduce the funds being disallowed in whole or in part, or not at all, as we find appropriate under the circumstances shown by the State. Some examples of good reasons are:
    - i. Disasters such as fire, flood or civil disorders, that
      - a. require the diversion of significant personnel normally assigned the AFDC eligibility administration, or
      - b. destroyed or delayed access to significant records needed to make or maintain accurate eligibility determinations.
    - ii. Strikes of State staff or other government or private personnel necessary to the determination of eligibility or processing of case changes;
    - iii. Sudden and unanticipated workload changes which result from changes in Federal law and regulation, or rapid, unpredictable caseload growth in excess of, for example, 15 percent for a 6-month period; and
    - iv. State actions resulting from incorrect written policy interpretation to the State by a Federal official reasonably assumed to be in a position to provide such interpretation.
  2. The failure of a State to act upon necessary legislative changes or to obtain budget authorization for needed resources does not constitute a factor beyond the State's control.
- h. Disallowance subject to appeal. If a State does not agree with our decision to reduce (disallow) FFP, it can appeal to us within 45 days from the date of our notice. The regular

procedures for appeal of disallowances will apply, including review by the Grant Appeals Board (see 45 CFR Part 16).

[FR Doc. 79-6787 Filed 3-6-79; 8:45 am]

[4110-35-M] Title 42-Public Health

CHAPTER IV-HEALTH CARE FINANCING ADMINISTRATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

PART 431-STATE ORGANIZATION AND GENERAL ADMINISTRATION

Medicaid; Fiscal Disallowance for Erroneous Payment

**AGENCY:** Health Care Financing Administration (HCFA), HEW.

**ACTION:** Final regulations.

**SUMMARY:** These regulations set forth provisions for reducing Federal financial participation (FFP) in erroneous State Medicaid payments identified through State Medicaid Quality Control (MQC) systems. They also provide that, before action is taken, the State will have an opportunity to show why the reduction should not be made.

These provisions are necessary because it is estimated that in Fiscal Year 1978 erroneous payments due to eligibility errors resulted in over \$1 billion in unnecessary Federal and State expenditures. The intent is to encourage States to implement strong corrective action programs that will reduce errors and save Federal and State funds.

**DATE:** Effective on March 7, 1977.

**FOR FURTHER INFORMATION, CONTACT:**

Victor Kugajevsky, Medicaid Bureau. Health Care Financing Administration, Room 3094, Mary E. Switzer Building, 330 "C" Street, S.W., Washington, D.C. 20201, (202) 472-3846.

**SUPPLEMENTARY INFORMATION:**

**BACKGROUND**

Since June 1975, the Department of Health, Education, and Welfare, together with the States has operated a Quality Control (QC) program in the Medicaid program. The focus of this QC program was to measure eligibility errors. On April 1, 1978, this QC system was revised so that it also measures Medicaid payment errors due to uncollected third party insurance and claims processing errors. The Quality Control system is designed to measure error rates for these three types of errors and provide information on the nature and cause of errors, so that corrective action may be untaken.

We recognize that it is not feasible for the States to administer an absolutely error-free program. However, we are concerned about our responsibility not to extend Federal financial participation (FFP) for erroneous expenditures, particularly when a State's error rate exceeds a level that it would reasonably be expected to achieve.

Prior to 1973, in the AFDC program, we withheld FFP only for erroneous payments uncovered in the Quality Control sample itself. In 1973, we promulgated for AFDC a regulation (38 FR 8743, April 6, 1973) that disallowed FFP for payments to ineligible persons and overpayments to eligible persons exceeding case error rate tolerance levels of 3 percent for ineligibility and 5 percent for overpayments.

On May 14, 1976, the U.S. District Court for the District of Columbia, *Maryland v. Mathews* invalidated these regulations, although it upheld our authority to promulgate rules of this nature. The Court specifically ruled as follows: (1) it upheld our interpretation that the Social Security Act does not require FFP in all erroneous payments; (2) it upheld our authority to promulgate a regulation providing for disallowance of FFP in some erroneous payments, (3) it confirmed that, under the efficient administration clauses of the various welfare titles of the Social Security Act, we have authority to set permissible error tolerance levels for erroneous payments; and (4) it rejected the specific error tolerance levels of 3 percent and 5 percent, on the ground that they had not been adequately justified by us at the time they were promulgated. Based on the evidence before it, the Court found the national error tolerance levels to be arbitrary and capricious and, accordingly, enjoined us from taking any disallowances based on these tolerance levels in the plaintiff States.

The Secretary decided not to appeal the Maryland decision. He also decided not to take disallowances in States which were not a party to the Maryland case but whose error rates exceeded the 3-percent and 5-percent tolerance levels. Instead, we undertook the development of a disallowance policy through extensive discussions with representatives of a number of State and local governments represented through the New Coalition (The National Conference of State Legislatures National Governors Association, the National Association of Counties, the National Conference of Mayors, and the National League of Cities), the American Public Welfare Association, and others. To further demonstrate good faith in these negotiations, the Secretary rescinded the disallowance regulations on March 16, 1977, and returned to the policy of disallowing FFP only for erroneous payments uncovered in the Quality Control sample itself.

The Medicaid Quality Control (MQC) program began in June 1975, when HEW issued regulations requiring States to implement a Medicaid QC program based on the AFDC QC program model. The AFDC and Medicaid QC programs were similar in conceptual design, except for the fact that Medicaid QC had no policy for disallowing FFP for erroneous expenditures above certain levels. In Medicaid, FFP was disallowed only for erroneous payments uncovered in the Quality Control sample itself. No broader disallowance provision has been promulgated before now. Although information is not available on all error rates, we know in the case of eligibility determinations for the medically needy that there was virtually no reduction in error rates under the prior MEQC system. We estimate that erroneous payments due to eligibility error resulted in over \$1 billion in unnecessary Federal and State expenditures in Fiscal year 1978. We, therefore, believe it is necessary to introduce a reasonable fiscal incentive to encourage States with high error rates to implement strong error reduction programs. This regulation is designed to fulfill this purpose.

## **SUMMARY OF THE REGULATION**

The Medicaid Quality Control program seeks reasonable progress in error reduction. Although technical assistance, training, and positive incentives have a role in achieving continued error

reduction, an effective error reduction program also needs national error standards and improvement targets, and appropriate fiscal disallowance when minimal progress is not achieved.

The fiscal disallowance policy in Medicaid embodies the following features. These principles are responsive to comments received on the proposed rule.

1. We propose to establish a series of nationwide eligibility error standards based on performance levels actually achieved by the States. We believe that actual performance best reflects States' administrative and managerial capabilities to lower error levels. Therefore, we will use the weighted mean of the eligibility payment error rate achieved by all States as the national standard.

The July to December 1978 MQC review period data will be used to set the first national standard. This standard will apply to the April-September 1979 and October 1979 to March 1980 periods.

A new national standard will be established each year based on the payment error rates achieved by the States in each April-September period. This new standard will apply to the second and third six month periods following the base period in which the national standard was set.

States with error rates above the standard will be expected to reduce their rates to one of two targets, whichever is higher:

- The national standard, or
- A 15.7% improvement in their error rate in the base period, (i.e., an error rate equal to 84.3% of the base period error rate).

States will be expected to take corrective action continuously to reach their error reduction targets. Any State failing to meet its error reduction target will be liable for a reduction in FFP. For example, if the national standard is 7%, a State with an error rate of 8% in the base period of July to December 1978 will be required to reduce its rate to the national standard by the end of the April to September 1979 period. If its error rate remains at 8%, the State would be subject to a disallowance in FFP of 1% for the period during which the target was to be met.

Some States may have payment error rates that are considerably above the national weighted mean. It would be unrealistic to expect these States to reduce their erroneous payment error rates to the national mean in one or two six month periods. To accommodate these States, we expect them to lower their payment error rates by at least 15.7 percent per year. The 15.7 percent figure is the average annual rate of reduction in eligibility errors achieved by all States in the AFDC program during the first 27 months after the AFDC Quality Control system was established in the April 1973 period. An example illustrating this situation follows.

If the State had an error rate of 15% in the base period, its error reduction target would be 2.4%, which is 15.7% of 15%. If this State's error rate remains at 15%. It would be subject to a disallowance of 2.4% for the period during which the target was to be met. The FFP disallowance is computed for, and taken against, Federal payments for medical assistance services furnished to recipients, (i.e., the State expenditures to which that State's Federal medical assistance percentage is applicable) by the percentage points indicated.

2. Completion of a State's designated QC sample is vital to the effective operation of Quality Control in Medicaid and to the proper implementation of this regulation. In the past, some States have not completed their Medicaid QC review samples and this may occur again. In order to deal with this contingency and, we hope, encourage the States to complete their reviews, this regulation authorizes HCFA to assign an error rate to a State for any QC review period for which it does not complete a valid review as required under Section 431.800. An assigned error rate would be treated in the same manner, for all purposes, as would the State's actual error rate.

HCFA will estimate an error rate for the State on the basis of the best information available to it. This may entail extrapolating from the State's prior QC error rate data from the AFDC or Medicaid eligibility QC systems. Alternatively, we may use data from comparable States, or a combination of data involving both the State in question and a comparable State's. Another alternative would be for HCFA to conduct a sample review itself. The method chosen would be tailored to the circumstances for a particular State and might vary from one State to another, depending on the nature of the available information.

We wish to stress the importance of a State completing its QC review and we will use the compliance procedure, as appropriate, against States that do not do so. However, by assigning an error rate, as specified in the regulation, we are also able to implement this regulation effectively and take reasonable measures to control erroneous expenditures. We think basing an error rate on the best information available gives us the flexibility to derive the best approximation of what the State's actual error rate would have been, had it completed the QC review. This retains consistency with the fundamental concept of this regulation, which is the calculation of a disallowance for estimated erroneous expenditures.

3. Since unusual and extraordinary circumstances could significantly affect a State's ability to meet error reduction targets, the fiscal disallowance policy will allow appeals when extenuating circumstances intervene.

We will not make a disallowance under certain conditions when the State can demonstrate that its failure to reach the national standard or the 15.7 percent improvement rate was due to factors beyond its control. The following conditions are illustrative:

1. Disasters such as fire, flood, civil disorders, etc., which:
  - a. Require the diversion of significant personnel normally assigned to Medicaid eligibility administration, or
  - b. Destroyed or delayed access to significant records needed to make or maintain accurate eligibility determinations.
2. Strikes of State staff or other government or private personnel necessary to the determination of eligibility and processing of case changes.
3. Sudden and unanticipated workload changes which result from:
  - a. Changes In Federal law and regulation, or
  - b. Rapid, unpredictable caseload growth in excess of, for example, 15 percent for a 6-month period.
4. State actions resulting from incorrect written policy interpretation to the State by a Federal official reasonably assumed to be in a position to provide such interpretation.

The failure of a State to act upon necessary legislative changes or to obtain budget authorization for needed resources will not constitute an acceptable excuse.

When we notify a State that it is subject to a disallowance, that State will have 65 days to present to us with reasons why it could not have reasonably met its target error rate.

The process within the Department for determining whether the State's failure to meet its target error rate was due to factors beyond its control will be informal. The Secretary has broad discretion to weigh all the facts and circumstances bearing on the State's ability to meet its target error rate.

The Secretary may decide to disallow the entire amount by which the State failed to meet its target rate, part of that amount, or none of that amount, according to the extent he concludes the State's ability was affected by factors beyond its control.

4. The State may request reconsideration of the Secretary's decision to take a disallowance. The reconsideration would be heard by the Department's Grant Appeals Board in accordance with procedures specified in 45 CFR Part 16.

## **DISCUSSION OF COMMENTS**

On July 7, 1978, a notice of proposed rulemaking was published in the FEDERAL REGISTER (43 FR 29311). Comments were received from 45 State and local welfare and health departments, 23 legal aid organizations and 14 private individuals, and public and private organizations. All comments were considered in preparing the final rule. These comments and our responses are discussed below. Changes from the proposed rule resulting from comments received are indicated in the discussion.

### **1. Appropriateness of the Fiscal Disallowance Policy.**

A major objection concerned the imposition of fiscal disallowances. The primary reasons given in support of that objection were: 1) imposition of a disallowance will reduce available State funds to cover costs of medical services for recipients, 2) our legal authority to impose disallowances is questionable, 3) disallowances for Medicaid are contrary to Congressional intent and may be counter-productive in reducing error rates. It was suggested that we follow a policy of fiscal incentives for MQC similar to that recently allowed for AFDC.

**Response:** The authority to promulgate regulations providing for a disallowance for erroneous expenditures is contained in Section 1903 of the Social Security Act. This authority is essentially the same as the authority for the AFDC Quality Control disallowance that was upheld in the District Court decision on *Maryland v. Mathews*. Although the commenters were correct that the Court's decision did not require us to implement a policy of fiscal disallowances, we believe that doing so will: 1) encourage States to reduce errors in the Medicaid eligibility process and 2) uphold our legal obligation to prevent or limit the use of Federal funds for erroneous and illegal payments.

We agree with the recommendation that incentive payments be provided to encourage

error reduction. Presently there is no legislative authorization in the Medicaid program to grant States fiscal incentives.

2. Counting Procedural and Client Errors.

Many States and legal aid organizations recommended that procedural errors due to the States' oversight in completing all necessary paperwork before awarding benefits, such as failure to register for WIN, should not be included in the error rate because, when corrected, they do not reduce total Medicaid payments. It has also recommended that we exclude errors caused by the recipient's failure to report Information to the State (client error). States indicated that, if they are held responsible for these errors, unreasonable verification requirements will have to be imposed on recipients.

**Response:** The procedural errors included in the error rate are established by law as eligibility requirements. Medical payments made for recipients who do not meet these eligibility requirements are subsequently not eligible for FFP. We believe that these errors are controllable, since they often require only better administrative controls.

We also believe that client errors can be controlled, because States that have reduced error rates substantially have been able to reduce both procedural and client errors. There is no empirical evidence that client errors cannot be controlled. If client errors were not included, States may potentially attribute all errors to the client. These errors have been included in our definition of the error rate so that States will be encouraged to develop mechanisms that will prevent and control client errors.

3. Inclusion of Underpayment and Negative Case Action Rates.

A number of commenters recommended that we include negative case actions (erroneous denial or termination of eligibility), and underpayment error rates in the definition of an eligibility error, thereby providing a more comprehensive scope to the disallowance policy. Legal aid organizations were concerned with the States' failure to adequately notify persons denied Medicaid benefits of fair hearing requirements that are provided by regulation. Some commenters recommended that we consider offering positive fiscal incentives to States that reduce negative case action rates, to offset disallowances imposed for erroneous eligibility determination.

**Response:** In our view, it is just as important that persons not be erroneously denied Medicaid services as it is that persons not be erroneously furnished Medicaid services. For that reason, we expect the States to reduce their negative case errors. We will monitor the States' performance through the negative case action Quality Control system and will continue to encourage States to develop corrective action programs to reduce and control negative case errors. We will also examine ways to establish incentives for reductions in negative case errors and other means to achieve lower negative case error rates. Moreover, we will use the compliance process when necessary to ensure that the States are properly affording applicants the fair hearings to which they are entitled. However, because this regulation is grounded on the disallowance of erroneous expenditures of funds and because a negative case action does not result in an erroneous expenditure, we have not included any method for taking a disallowance based on negative case actions.

4. The 4% National Goal.

The proposed regulation would have established a 4% national goal for error reduction, and provided that its reasonableness would be determined on the basis of an 18 month study.

A number of States opposed the 4% national goal indicating: 1) it is arbitrary and capricious, 2) it fails to meet the test of an empirical foundation, 3) it is contradictory to establish a standard while it is under study, 4) a 5% level would be more realistic (although remaining arbitrary), 5) an improvement rate is more realistic than a fixed standard, and 6) it is unreasonable to apply AFDC standards to Medicaid.

**Response:** We have accepted the States arguments on this issue and will not utilize the 4 percent as an interim goal in Medicaid. However, we will undertake an 18 month study of the reasonableness of a fixed national percentage. Based on the study results, we will review the possible reintroduction of an empirically based ultimate error rate reduction goal.

5. Individual State Goals.

Many States recommended the use of individual State standards rather than a national goal. There was some support for the concept of grouping States by comparable program variables and complexity.

**Response:** We have rejected these concepts as being impractical and unmanageable. because of the extensive administrative difficulties associated with monitoring 53 standards. Grouping States by comparable variables is difficult since there is no consensus on what these variables should be to group States into like clusters with comparable error rates. We would prefer to use a national standard because it is uniform, easier to administer, and offers a basis for comparative ranking for each State.

6. Use of Weighted Mean vs. Median.

The proposed regulation would have set a national error standard at the 50th percentile (median) of the payment error rate achieved by all States (until this was reduced to 4 percent). A number of States were concerned that this proposal disregards differences among State programs. They argued that a weighted average (mean) more accurately reflects the differences in case-loads and expenditures among the various Jurisdictions.

**Response:** We agree that the mean is more accurate than the median as a reflection of the pattern of erroneous expenditures, and is an accurate empirical mid-point between high and low error rate States. Therefore, we will use the weighted mean.

7. The 13% Annual National Historical Average Rate of Improvement: Applicability of AFDC Data to Medicaid.

The proposed regulation provided that States with error rates above the median would not necessarily have to reduce the rate to the median within a single period. As an alternative, the payment error rate could be reduced by at least 18 percent per year without any loss

of FFP.

The 18 percent represents the average annual reduction rate achieved by all States in the AFDC program between the April-September 1973 period and the July-December 1976 period. A large number of commenters objected to the use of the historic rate for the following reasons: 1) it is unreasonable to impose a reduction rate on the Medicaid program that is based on AFDC historical data, 2) the 18% figure is not based on the most current AFDC period available, i.e., inclusion of July-December 1977 data reduces the historic improvement rate of 14%, 3) it is unreasonable to assume a continuing reduction of error rates (as the error rate falls, the remaining errors are more difficult to correct). In fact, attempts at further reductions below a certain level of errors may not be cost effective, 4) the base period of four or five years used in creating the improvement rate is excessive,

5. the 18% improvement factor is derived on a national average basis and disregards individual State improvement records, i.e., it is unreasonable to expect individual States to meet the historical record of all States.

**Response:** We believe that it is reasonable to expect States with error rates above the established national standard to reduce their error rate by at least the national historic improvement rate. The annual improvement rate has been changed to 15.7%. This figure is based on the average rate of improvement in AFDC eligibility errors during the first 27 months of operation of the AFDC Quality Control system. We believe this figure is better than the 18% used in the NPRM for the following reasons:

1. The 15.7% is based only on AFDC eligibility errors whereas the 18% was based on both overpayments and eligibility errors. Since the Medicaid disallowance will relate only to eligibility errors using AFDC data only for eligibility errors increases the comparability between the AFDC data and the Medicaid experience to be measured.
2. Because the MQC system was recently revised (to utilize a larger sample, provide better data, and place more emphasis on error reduction) and because there has been no significant improvement between 1975 and 1977 under the prior MEQC system, we think the present situation in Medicaid is essentially the same as AFDC at the beginning of its QC program in April 1973.
3. We believe the present error rate in Medicaid is still high enough to warrant the expectation of reducing it, during the next 24 months, at the historical rate experienced by AFDC during the April-September 1973 to January-June 1975 periods.

This 15.7% rate will be held constant for 2 years, because we believe present error rates are still at a high enough level for us to expect a continuation of the historical rate of error reduction. After two years, we will re-examine this standard. We are taking this approach in order to develop a strong error reduction program in Medicaid that will reduce State and Federal dollar losses due to eligibility errors.

8. Federal Fiscal Liability for SSI Eligibility Errors.

A number of States objected to the provision that would make them responsible for payment

errors made to Medicaid recipients because the Social Security Administration (SSA) determinations of eligibility for aged, blind, and disabled Supplemental Security Income (SSI) recipients were incorrect. The NPRM specified that States that have SSA determine Medicaid eligibility for SSI recipients under an agreement with SSA under Section 1634 of the Act, would not be responsible for SSA determined eligibility errors. States indicated that, by implication, the NPRM held States without Section 1634 agreements responsible for SSA determined eligibility errors. However, States that do not have 1634 agreements with SSA must, under Section 1902(a)(10) of the Act, automatically make SSI recipients eligible for Medicaid, unless they exercise the option under Section 1902(f) of the Act to adopt more restrictive eligibility criteria (the latter are commonly called "209(b) States.") Commenters also recommended that the Medicaid program be reimbursed by SSA for expenditures made on behalf of ineligible SSI recipients. In addition, States questioned the validity of holding them responsible for unnecessary SSA delays in notifying the State that a former SSI recipient has become ineligible.

**Response:** The final regulation has been changed to provide that SSI ineligibility errors will not be included in the Medicaid error rate. This applies whether or not the State has a Section 1634 agreement with SSA. This does not, of course, apply to 209(b) States. 209(b) States will have eligibility errors for all Medicaid recipients included in determining their Medicaid error rate.

We understand the concern of States in requesting some type of reimbursement from SSA for erroneous Medicaid expenditures made on behalf of ineligible SSI recipients. However, there is no provision under the Social Security Act to reimburse States for these expenditures. States will not be held responsible for SSA caused delays in receiving notification that a SSI recipient has lost eligibility.

#### 9. Changing the implementation Time Frames.

A number of States believe the proposed time frames are unrealistic. Comments included the following: 1) the initial base period should be revised from July-December 1978, to October 1978-March 1979, so that there could be conformity between this cycle and the standard MQC cycle, 2) the proposed 6-month period for corrective action is insufficient, 3) the initial three month grace period for the present MQC system is too short, 4) since the State summary report on eligibility findings is not required until eight months after the conclusion of the sample period and corrective action plans are not required for ten months, the corrective action period will not be helpful, 5) there are no constraints on us to produce statistical information in a timely manner.

**Response:** We have considered these views carefully, because we realize that the time frames specified in this regulation appear to be very short. However, we think the problems are not as difficult as the commenters suggest.

The MQC regulation implementing the expanded QC program became effective April 1, 1978, and established the initial sampling period to be July through September 1978. (See 43 FR 13574; March 31, 1978.) This regulation does not change the requirements for the QC reviews. (See 42 CFR 431.800.) States, therefore, should be conducting the required reviews and collecting the appropriate data needed to implement this regulation. Moreover, the States are supposed to be developing and reporting monthly data on eligibility errors under section 431.800(e)(2). Thus, even though the first base period under this regulation does not coincide

with the 6-month sampling periods established under section 431.800, the States are not seriously inconvenienced, if they collect monthly data.

In addition, if the States use this monthly data during the base period, they know approximately what their eligibility error rate for the first base period will be. Although the commenters are correct that Section 431.800(e)(4) does not require the State to submit its summary report until 8 months after the sampling period, the base period error rates, national standard, and State error reduction targets can be estimated on the basis of monthly reports. We understand the need of the State to know their error reduction targets as soon as possible and will do everything we can to make this information available at the earliest possible date.

The commenters are also correct that a State's corrective action plan required under Section 431.800(g) is not due until July 31 each year. However, the fact that the State must submit its corrective action plan to us only once a year does not preclude a State from undertaking whatever corrective action it concludes is necessary throughout the year in order to reduce its error rate.

In the final regulation, we have deleted the use of the term "corrective action period" because we believe it is misleading. States are expected to take corrective action to reduce errors on a continuous basis rather than focusing corrective action efforts only on the period between the base and disallowance periods. The use of the term "corrective action period" implied that there was period each year during which States were not subject to a disallowance. This is not true, since States are continuously subject to review for possible disallowance, beginning with the April-September 1979 review period.

The final regulation retains the sequence under which (after the first cycle) there is an April-September base period each year that is used to establish a target error rate applicable to the subsequent April-September and October-March review periods.

In our view, since the States will have monthly data from the beginning of the base period, they will have an advance indication of the frequency, nature, and causes of their eligibility errors. This lead time, plus the lag that occurs during the first disallowance period before it can be determined whether the State met its target, results in the State having well over six months to take corrective measures.

We understand the commenter's concern about the first period of disallowance beginning in April 1979. However, we think it is essential to implement this regulation promptly in order to carry out our responsibility not to extend FFP for erroneous expenditures. We also want to get on the regular MQC schedule as soon as possible. As noted above, the States have lead time to determine both their error rate and the reasons for the error rate. It is in the interests of the State to take corrective measures as soon as possible, even if the State is below the national standard, to reduce erroneous payments. We have decided, therefore, to retain the schedule set forth in the NPRM.

#### 10. Determining the Magnitude of an Erroneous Payment.

Several commenters questioned the method utilized in the MQC program in determining the amount of payment in error, particularly in cases involving medically needy spend down requirements. The comments were apparently directed at the Medicaid Quality Control manual

which does indicate that in certain circumstances the amount of the erroneous payment is the full amount of the total Medicaid payment, not just the amount of the spend down error which renders the recipient ineligible. States indicated that the policy should be changed to reflect simply the amount of the spend down error and not the entire amount of the Medicaid payment as the error.

**Response:** The statute requires that the spend down must be "incurred" before the recipient becomes eligible for Medicaid services [Section 1903(f) of the Act]. In our view, once the dollar amount of Medicaid services furnished the recipient exceeds his required spend down, the recipient may properly be said to be eligible for purposes of MQC review. Therefore, if a State furnishes medical services before the recipient has incurred his spend down, our current policy is to set the amount of the State's payment error equal to the lower of the unmet spend down or the medical expenses. The following cases illustrate this policy:

**Case 1.** Upon application for Medicaid, a person is told by the State agency that his spend down is \$100. The person incurs the \$100 spend down, receives a Medicaid card, and has medical expenses for the next month of \$50 paid for by Medicaid. The QC review then picks the case for review and finds that the correct amount of the spend down should have been \$125. Thus, there is a spend down error. The dollar amount counted in error is the smaller of (a) unmet spend down (\$25), or (b) medical expenses paid for by Medicaid (\$50).

**Case 2.** In this case, the person's spend down liability is properly determined by the State agency to be \$125. However, before he incurs any medical expenses, he is given a Medicaid card by the State and receives benefits of \$500. The case is picked for MQC review and the error is found. In this case, the amount of the error is \$125, which is the unmet liability.

In the earlier Medicaid Eligibility Quality Control system, Case 2 would have been considered ineligible, and the entire amount of the Medicaid payment considered as a \$500 error. This would have included the unmet spend down and the remainder of the payment which would have appeared to be valid.

Under the present MQC system, the procedure is to consider the smaller amount to be the error, as cited in Case 1. The person's eligibility is valid at the time that the expenses are incurred.

## 11. Compliance with Executive Order 12044.

Several commenters said we failed to comply with the requirements of Executive Order 12044. This order, signed by the President on March 23, 1978, provides that proposed regulations that will have major economic consequences must be accompanied by a detailed regulatory analysis that includes an examination of alternative approaches considered in the decisionmaking process.

**Response:** This regulation does not have sufficient economic impact to warrant regulatory analysis as required by the Executive Order. We have met the extensive public involvement requirement of the Executive Order through the extensive discussions with the public welfare community and the use of the standard 60 day comment period. Many alternatives were examined in the development of this regulation. Some of these issued were:

1. Use of a national standard versus individual State standards;

2. Reduction of error rates in stages versus immediate application of a standard;
3. Use of the payment error rate versus the case error rate; and
4. Should "good cause" exceptions exist for failure to meet the prescribed error rate.

Many States and other members of the public welfare community responded to the NPRM, which would indicate that there were alternatives presented in sufficient detail.

## 12. Appeal Process.

A number of commenters requested greater specificity of the appeals procedures, and a broadening of the good cause exceptions. Several States disagreed with the concept that the failure of a State to act upon necessary legislative changes or budget authorizations is an unacceptable excuse for not meeting error rate reductions targets.

**Response:** The final rule retains the provisions regarding good cause exceptions. We disagreed with the general statements that the factors given as examples should be broadened. Because a State's failure to act upon legislative changes or to obtain budget authorization is within State control, in our view. It does not justify a State's failure to administer the Medicaid program effectively and to meet error reduction goals.

We have not established a formal administrative process for the Secretary's review of the State's good cause request. We believe this process must necessarily be informal, permitting a free interchange between the Secretary and the State, and allowing the Secretary to consider all the pertinent facts and circumstances. The Secretary's decision on whether the State's failure to meet its target was due, in whole or part, to factors beyond its control necessarily requires a judgmental weighing and balancing of many considerations. However, we have added a provision specifying that a final disallowance by the Secretary is subject to reconsideration by the Grant Appeals Board. (See 45 CFR 201.14 and 45 CFR Part 16.)

## 13. Separate Tolerance Levels for Third Party Liability and Claims Processing.

We also requested suggestions regarding the proposal to apply fiscal reductions to erroneous payments resulting from Third Party Liability (TPL) and Claims Processing (CP) errors and, also, combining the three types of errors-ineligibility, Third Party Liability, and Claims Processing into a single payment error tolerance.

A number of States suggested: 1) that no tolerance level should be established for TPL and CP because there is a lack of empirical data available at this time, 2) if tolerance levels are established, they should be separate for each component.

**Response:** For the time being, we will not set a tolerance level for these types of errors. We do plan on doing this in the near future.

## 14. State Failure to Complete Quality Control Reviews.

The proposed regulation requested suggestions for possible methods of discouraging State failure to complete required QC sample reviews within the appropriate time frame. Recommendations to this request were: 1) the current compliance process is adequate, 2) error rates assigned to States that fail to complete required reviews should be specified, and this rate should be applied only if more than 11% of the States fail to complete their reviews, 3) an increase in FFP to 75-

90% for QC costs would be more effective, and 4) States might prefer accepting a nation-wide error rate to publication of its own, probably higher, error rate.

**Response.** As discussed in item 2 under the Summary of the Regulation, we believe it is essential to have a method for assigning an error rate to States that do not complete their QC reviews. The method we chose is to estimate the State's error rate using the best information available to us. In our view, this is more logical and more consistent with the basis for the regulation than any of the suggestions. The error rate should be tied as specifically as possible to the actual experience of the State in question, rather than set at some arbitrary national rate or based on the experience of States whose experience or characteristics might not be comparable. The suggestion that a rate be assigned only if more than 11% of the States fail to complete reviews does not have any apparent rationale. Moreover, the method for assigning a rate should not yield a rate that would be lower than the actual rate would have been, since this would act as an incentive not to complete the review. Finally, since this regulation is grounded on the disallowance of erroneous payments, rather than a sanction for failure to comply with statutory or regulatory requirements, there is no basis for assigning an arbitrarily high rate that has no relationship to the State in question.

42 CFR Part 431, Subpart P is amended by adding a new § 431.801 to read as follows:

Subpart P-Quality Control Sec.

431.800 Medicaid Quality Control (MQC) system.

431.801 Disallowance of Federal financial participation for erroneous State payments.

Subpart P-Quality Control

431.801 Disallowance of Federal financial participation for erroneous State payments.

- a. Purpose. This section establishes rules and procedures for disallowing Federal financial participation (FFP) in erroneous Medicaid payments due to eligibility errors, as detected through the Medicaid Quality Control (MQC) system required under 431.800 of this subpart.
- b. Definitions. For purposes of this section "Base period" means a six month MQC sampling period used to calculate each State's error rate and the national standard. The Initial base period is July through December 1978. For subsequent years, the base period is April through September.

"Eligibility errors" has the same meaning as specified in 431.800(b).

"National standard" means the weighted mean of all State error rates for a base period.

"State error rate" means the rate of eligibility payment errors detected under the MQC system for each review period.

"State target error rate" means the error rate that a State must achieve in order to avoid a disallowance of FFP under this section. A State's target error rate is equal to the higher of the national standard or percent of that State's error rate during the base period.

- c. Setting the State's error rate. An error rate for each State will be determined for each MQC review period, in accordance with instructions issued by HCFA. Erroneous

eligibility determinations by the Social Security Administration (SSA) of Supplemental Security Income (SSI) eligibility will not be included in determining the State's error rate. If a State fails to complete a valid MQC review as required for any sampling period, HCFA will assign the State an error rate based on the best information available to HCFA.

- d. Establishing the target error rate. Each year, after the end of the base period, HCFA will calculate a national standard and will notify each State agency what that State's target error rate is for the following April through September and October through March MQC review periods.

Example. The State's payment error rate in the base period is 20 percent. The national standard is 8 percent. To find the target error rate, we start with 20 percent and multiply by 84.3 percent which gives a target error rate of 13.9 percent. If this State reduces its error rate only to 18.2 percent during one of the subsequent disallowance periods, its FFP for that period may be reduced by 1.3 percent, the short fall from the 16.9 percent target.

- e. Period for disallowance of FFP.

The State target error rate established for each base period will be used to determine whether the State is subject to a disallowance during the following April through September and October through March MQC review periods. During each of these two periods, a State will be subject to a reduction in FFP for program services (see § 433.10 of this subchapter) equal to the percentage points by which it exceeded its target error rate. The first disallowance period will be April through September, 1979.

- f. Procedures for disallowance of FFP.
  1. (1) HCFA will notify each State that is subject to a disallowance under paragraph (e) of this section. A State will have 65 days from the date on this notification in which to show that this disallowance should not be made because the State's failure to meet its target error rate was due to factors beyond Its control.
  2. Events that will be considered by the Secretary in determining whether a State's failure to meet its target error rate was due to factors beyond its control include:
    - i. Disasters such as fire, flood or civil disorders, that
      - a. require the diversion of significant personnel normally assigned to Medicaid eligibility administration, or
      - b. destroyed or delayed access to significant records needed to make or maintain accurate eligibility determinations.
    - ii. Strikes of State staff or other government or private personnel necessary to the determination of eligibility or processing of case changes;
    - iii. Sudden and unanticipated workload changes which result from changes in Federal law and regulation, or rapid, unpredictable caseload growth in excess of, for example, 15 percent for a 6 month period; and
    - iv. State actions resulting from incorrect written policy interpretation to the State by a Federal official reasonably assumed to be in a position to provide such interpretation.
  3. The failure of a State to act upon necessary legislative changes or to obtain budget authorization for needed resources does not constitute a factor beyond the State's control.

4. The Secretary may disallow the full amount calculated under paragraph (e) of this section or reduce the disallowance in whole or in part, to the extent he determines that the State's failure to meet its target error rate was due to factors beyond its control.
5. A State may request reconsideration of a disallowance under this section in accordance with the procedures specified in 45 CFR 201.14 and 45 CFR Part 16.

(Sec. 1102 of the Social Security Act, 42 U.S.C. 1302.)

(Catalog of Federal Domestic Assistance Program No. 13.714, Medical Assistance Program.)

Dated: February 13, 1979.

LEONARD D. SCHAEFFER,  
Administrator, Health Care Financing Administration.

Approved: February 21, 1979.

JOSEPH A. CALIFANO, Jr.,  
Secretary.