
CMS Manual System

Pub. 100-06 Medicare Financial Management

Department of Health & Human Services (DHHS)
Centers for Medicare & Medicaid Services (CMS)

Transmittal 26

Date: DECEMBER 8, 2003

CHANGE REQUEST 2885

I. SUMMARY OF CHANGES: Change from full costing to incremental cost budgeting and reporting for productivity investment projects in the Contractor Administrative Budget and Financial System (CAFMI).

NEW/REVISED MATERIAL - EFFECTIVE DATE: January 5, 2004

***IMPLEMENTATION DATE: January 5, 2004**

Disclaimer for manual changes only: The revision date and transmittal number apply only to red italicized material. Any other material was previously published and remains unchanged.

II. CHANGES IN MANUAL INSTRUCTIONS:
(R = REVISED, N = NEW, D = DELETED)

R/N/D	CHAPTER/SECTION/SUBSECTION/TITLE
R	1/90.10/Allocation of Overhead and General and Administrative Costs
R	1/100.6/ Productivity Investments (PI) Function (Summary Level Code 17000)

***III. FUNDING:**

Funding is available through the regular budget process for costs required for implementation.

IV. ATTACHMENTS:

X	Business Requirements
X	Manual Instruction
	Confidential Requirements
	One-Time Notification

***Medicare contractors only**

Attachment - Business Requirements

Pub. 100-06	Transmittal: 26	Date: December 8, 2003	Change Request 2885
-------------	-----------------	------------------------	---------------------

SUBJECT: Change From Full Costing to Incremental Cost Budgeting and Reporting for Productivity Investment (PI) Projects in the Contractor Administrative Budget and Financial System (CAFMI)

I. GENERAL INFORMATION

A. Background:

Direct, Overhead and General and Administrative costs related to Productivity Investments are to be budgeted and reported on an Incremental cost basis in the Contractor Administrative Budget and Financial System (CAFMI). Existing procedures require full costing of Productivity Investment Projects. Full costing necessitates a reallocation of indirect costs (Overhead and G&A) and potential transfer of direct costs from ongoing activities when a PI project is submitted as a Supplemental Budget Request (SBR) and subsequently approved.

Medicare contractors are instructed to exclude costs related to PI projects in their initial Budget Requests. Under the full costing method, a subsequently approved PI project will absorb a portion of costs from ongoing activities. The resulting cost reduction to current year ongoing line items can adversely affect subsequent years budgets for ongoing activities. This occurs since a portion of direct and overhead costs that are either fixed or semi-variable in nature are excluded from the current year's recorded ongoing activities cost.

B. Policy: N/A

C. Provider Education: None.

II. BUSINESS REQUIREMENTS

"Shall" denotes a mandatory requirement

"Should" denotes an optional requirement

Requirement #	Requirements	Responsibility
2885.1	Contacto shall revise their budgeting for Productivity Investments Projects from full costing to an incremental costing method.	Medicare contractors

III. SUPPORTING INFORMATION AND POSSIBLE DESIGN CONSIDERATIONS

A. Other Instructions: N/A

X-Ref Requirement #	Instructions

B. Design Considerations: N/A

X-Ref Requirement #	Recommendation for Medicare System Requirements

C. Interfaces: N/A

D. Contractor Financial Reporting /Workload Impact: N/A

E. Dependencies: N/A

F. Testing Considerations: N/A

IV. SCHEDULE, CONTACTS, AND FUNDING

Effective Date: January 5, 2004 Implementation Date: January 5, 2004 Pre-Implementation Contact(s): Robert Stabile (410) 786-2602 or rstabile@cms.hhs.gov Post-Implementation Contact(s): Robert Stabile (410) 786-2602 or rstabile@cms.hhs.gov	Funding is available through the regular budget process for costs required for implementation.
--	---

**90.10 - Allocation of Overhead and General and Administrative Costs –
(Rev. 26, 12-08-03)**

A1-1212.10, B1-4212.10

The contractor shall allocate overhead and general and administrative costs to all activities *with the exception of productivity investment (PI) activities. Incremental overhead and general and administrative costs attributable to PI projects should be eliminated from the allocation pool and included in the overhead and general and administrative cost line items of the PI project.* These allocations should be based on the ratio of each activity's total costs to the sum of all activity costs. Included in costs are salaries and wages, fringe benefits, EDP Equipment, other direct costs, other costs (if applicable), and non-COB credits. It shall exclude subcontract costs from the calculation.

For example, the only ongoing activities the contractor performs is for Bills/Claims Payment and Appeals. The Total Costs prior to " other adjustments" of salaries and wages, fringe benefits, EDP equipment, other direct costs, other costs, and non-COB credits equals \$1,000,000 for the Bills/Claims Payment and the Subcontract cost is \$100,000. The same costs are \$250,000 and \$25,000 for Appeals and \$50,000 and \$75,000 for Productivity Investments. Overhead for this period totaled \$77,000 and general and administrative (G&A) costs totaled \$26,000.

Subcontract costs, other adjustments and forward funding are not considered in this allocation.

	Salaries & Wages, etc.	Overhead Allocated	Percent Allocated	G&A Allocated	Percent Allocated	Sub-contracts	Total Cost
Bills/Claims Payment	\$1,000,000	\$60,000	80%	\$20,000	80%	\$100,000	\$1,180,000
Appeals	250,000	15,000	20%	5,000	20%	25,000	295,000
Prod. Investments (PI)	50,000	2,000	0%	1,000	0%	75,000	128,000
Total Cost	\$1,300,000	\$77,000	100%	\$26,000	100%	\$200,000	\$1,603,000
Less PI	(50,000)						
Basis for Allocation	1,250,000						
Less PI Overhead & G&A		(2,000)		(1,000)			
Allocable Overhead & G&A		75,000		25,000			

The basis for this allocation excludes the direct PI cost and the incremental Overhead and G&A costs attributable to the PI. In this example, 80% of the non-incremental Overhead and G&A were allocated to Bills/Claims Payment because this activity comprises 80% of the cost the total allocation base for Salaries & Wages, etc. (\$1,000,000/\$1,250,000).

100.6 - Productivity Investments (PI) Function (Summary Level Code 17000) (Rev. 26, 12-08-03)

A1-1213.6

The contractor shall include the cost of activities related to the development and implementation of approved PIs and administrative enhancements as directed by CMS.

A - Activity Codes for PIs

Activity codes for PIs will be assigned to approved projects. A list of approved PIs will be available in CAFM II. The contractor shall use only approved PI codes. The miscellaneous PI activity code may be used only on the initial BR and the SBR for projects that have not been approved and do not have an assigned PI activity code. It shall not use the miscellaneous PI Activity Code on an IER or FACP.

1 - PIs include administrative enhancements and legislative mandates directed by CMS that are considered essential for maintenance of effective program operations. They do not necessarily generate program savings.

2 - PIs may include activities that affect more than one Medicare function and are administered as a PI.

3 - PIs also include systems conversions and transitions. See D below.

B - PI Funding

PI funding is generally for first year start up costs only. Funding for subsequent years is generally treated as an ongoing cost, not a PI, and should be included as an ongoing operational cost in the contractor's BR. If PI funding after the first year is requested, a schedule with funding for each FY should be included in the initial request for funding. If CMS determines that PI funding for subsequent FYs is authorized, the contractor should include the PI funding authorized in its BR every year it is authorized.

C - PI Costs

The contractor shall report incremental direct costs and incremental overhead and general and administrative costs. If some of the non-incremental direct costs are incurred due to reallocation of staff time, document it but do not request funding. Incremental direct costs and incremental overhead and general and administrative costs may include:

- Incremental personal service costs of staff and management directly involved in the project (including programmers).*
- Materials and supplies used for the project*

- *Subcontract services, such as feasibility studies done under contract.*
- *EDP costs including data conversion, computer time and EDP support services that are incurred only if the project is done. These costs should be spread to the appropriate cost categories on the Activity Form. See Section 90.9. Include special charges under a facilities management contract for programming changes. Depreciation on equipment purchased in conjunction with the project should be shown in the EDP equipment cost category; and*
- *Incremental overhead and general and administrative costs caused by any increase:*
 - *in the cost incurred for overhead or general and administrative functions (described in 90.9.H and 90.9.I) as a result of the PI project implementation , or*
 - *in the Medicare allocation from the corporate overhead or general and administrative pool due to an increase in the cost allocation base*

D - System Conversions and Transitions

The following costs are included in systems conversions and transitions and may also apply to other projects:

- **Project Management Costs** - Costs of essential staff/management project support;
- **Software Installation Costs** - Costs for installing and testing the software;
- **File Conversion Costs** - Costs for converting to the new system including the costs of mapping, software development and testing;
- **Interface Development and Implementation Costs** - Costs to interface with external programs e.g., for electronic data interchange, check writing, 1099 preparation, other reports and forms;
- **Training Costs** - Costs of staff training including train the trainer, technical staff and user staff training costs; and
- **Other Costs** - Costs of provider education, outreach, and post- implementation problem resolution.

E - Cost-Benefit Documentation for PI Projects

1 - General

Before funding will be approved for a project that is proposed by a contractor, it must be demonstrated to be cost-beneficial. A project will generally only be approved if the net present value (NPV) for the project is equal to or greater than zero. The present value of the savings is at least equal to the costs of implementation when both are discounted to the same start date. As a general rule, CMS will consider only projects having a positive NPV over 2 years. However, the contractor shall provide probable costs and savings taken over all years of the project.

This documentation does not supplant the existing prior approval process or the threshold amounts specified in the Medicare contract/agreement for system enhancements and subcontracts.

2 - Applicability

The contractor shall include cost-benefit documentation with all requests for PI funds. The amount of the documentation required depends on the estimated cost and complexity of the project. Administrative enhancements and systems transitions directed by CMS are not subject to this cost-benefit test unless specifically required by CMS.

3 - Documentation

The contractor shall document cost-benefit analysis using NPV calculations of costs and savings discounted to the start date. A narrative explanation of cost-benefit analysis should identify the assumptions for the analysis such as the start date, discount rate, and costs and savings in each fiscal year. The contractor shall include the following items in documentation:

- **Estimated Cost** - The contractor shall show cost items in categories reported for activities. See §90.9 for cost categories. It shall provide underlying cost details and the assumptions on which they are based for each material cost item. It shall include personnel, machine time, materials and outside services in the estimate of costs. It shall also include EDP charges and overhead. For capital expenditures in excess of \$500, it shall use standard procedures for establishing the asset's useful life and for the depreciation schedule. CMS pays expenses when incurred; the contractor shall include the proper depreciation and return on investment for the period before implementation in its analysis.
- **Administrative Cost Savings** - The contractor shall outline any savings in staff time, postage, and computer time. It shall include only cost reductions, not cost avoidance. It shall reduce these savings by increases in administrative costs attributable to the project (e.g., temporary productivity losses due to learning curve, "downtime" for problem resolution, and depreciation for equipment purchased).
- **Benefit Savings** - The contractor shall estimate the amount of benefit savings, if any, which result from preventing or recovering erroneous payments, based on policy in effect at the time of the analysis.

- Discount Rate - The contractor shall use the interest rate applicable under the Prompt Payment Act to discount both the savings and costs to the start date. The interest rate is published in the **Federal Register**.

- Start Date - This is the point in time where the project first incurs costs and is the date in time used to determine the Net Present Value of the project.

F - PI Workload

The contractor shall report no workload unless directed by CMS.