

Attachment A to the
Texas Transformation and Quality Improvement Program 1115 Waiver:
Agreement between Health & Human Services Commission and Anchor



**Cost Principles for Expenses
for the 1115 Waiver - Administrative Services**

EFFECTIVE DATE

October 1, 2012**Version 1.0**

DOCUMENT HISTORY LOG

STATUS ¹	DOCUMENT REVISION ²	EFFECTIVE DATE	DESCRIPTION ³
Baseline	1.0	October 1, 2012	<p>Initial version is broadly based on the Medicaid/CHIP managed care contract's Uniform Managed Care Manual, Chapter 6.1, Cost Principles, Version 2.2, which became effective for those contracts on Oct. 15, 2012. Note that this version applicable to the 1115 Waiver Anchor Administrative Services contracts has important differences from versions written for the HMO managed care contracts.</p> <p>The initial effective date corresponds to the beginning of Demonstration Year 2.</p>
<p>¹ Status should be represented as "Baseline" for initial issuances, "Revision" for changes to the Baseline version, and "Cancellation" for withdrawn versions.</p> <p>² Revisions should be numbered in accordance according to the version of the issuance and sequential numbering of the revision.</p> <p>³ Brief description of the changes to the document made in the revision.</p>			

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Cost Principles for Expenses for the 1115 Waiver – Administrative Services

Applicability of Attachment A, Cost Principles for Expenses for the 1115 Waiver

This Attachment A, Cost Principles for Expenses for the 1115 Waiver – Administrative Services (the “Attachment,” or, the “Cost Principles”), is incorporated by reference into the agreement (the “Contract”) between the Health and Human Services Commission (“HHSC”) and the Anchor (or “Contractor” or “Anchoring Entity”), with respect to the Texas Transformation and Quality Improvement Program 1115 Waiver (the “Waiver”). The Contract provides for a delegation of certain administrative functions to the Anchor by HHSC with respect to the implementation of the Waiver, and a mechanism for certain payments to the Anchor relating to the Anchor’s cost of these administrative functions. The terms of this Attachment are applicable to the costs reported by the Anchor and submitted to HHSC for reimbursement or other payment under the Contract. As such, the terms herein are also applicable to any costs incurred by any Affiliate of the Anchor, wherein such costs are included, directly or indirectly, in those submitted by the Anchor for reimbursement or payment by HHSC.

Not all types of costs that might be incurred by the Anchor in connection with the performance of its administrative functions under the Contract are allowable. It is the function of these Cost Principles for Expenses to clarify this issue.

While this Attachment was derived from similar cost principles used by HHSC with respect to managed care and other contracts, there are substantive differences. The specific terms of this Attachment are the definitive cost principles with respect to the Contract.

In spite of a specific cost being deemed allowable herein, such allowable costs, in aggregate, may be subject to a maximum limit, or cap, as defined in the Contract and its incorporated documents.

References to a cost being “reimbursed” does not imply that the recipient of such payment would then have no net cost (after reimbursement); the role of Inter-Governmental Transfers (IGT), as defined in the Contract, significantly alters the ultimate net financial impact to the Anchor.

The Anchor is a member of a Regional Healthcare Partnership (RHP), and may be a public hospital (or, alternately, is either a hospital district or other hospital authority, or a county government, or a state university). The Anchor is responsible under the Contract for coordinating RHP activities, and assisting HHSC in the performance of key oversight and reporting responsibilities.

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I. General

A. Introduction

Cost Principles for Expenses contain principles to be applied in establishing the allowability or unallowability of expenses, including any subcontract expenses and affiliate expenses, related to the Contract. The allowability or unallowability of expenses impact the amount that may be paid or reimbursed to the Contractor by HHSC in accordance with the Contract’s requirements. These principles apply to both direct and indirect costs. A cost is allowable only to the extent of benefits received by HHSC under the Contract, and to the extent that the cost conforms to the policies, principles, and requirements of this Attachment.

All costs reported to HHSC for payment or reimbursement under the Contract are subject to the cost allowability requirements under the Cost Principles. Until audits, if applicable, are completed, amounts are subject to revision, according to the Cost Principles.

Costs limited to specific functions. Allowable costs under the Contract are limited to certain narrowly-defined tasks and job functions directly connected to the performance of the administrative efforts required and specified in the Contract, plus appropriate allocations for indirect support. The specific tasks and job functions required by the Contract consist of the following:

- Provide accounting, human resources, and data management resources for the RHP;
- Coordinate RHP annual reporting, as specified in the Program Funding and Mechanics Protocol, on the status of projects and the performance of Performing Providers in the region (as those terms are defined in the Contract or RFP);
- Provide RHP data management for purposes of evaluation;
- Develop and facilitate one or more regional learning collaboratives;
- Communicate with stakeholders in the region, including the public; and,
- Communicate on behalf of the RHP with HHSC.

Thus, many of the functions that might be allowable under other types of HHSC contracts, such as those with managed care operations, are not relevant to the scope of this Contract, and are therefore not allowed herein. Costs included in cost reports submitted by the contractor to HHSC for payment or reimbursement that are for other functions, or that do not support the above functions, are unallowable hereunder.

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B. Relevance of the Federal Acquisition Regulations ("FAR").

All amounts reported to HHSC by the Contractor, including costs, fees, assessments, affiliate transactions, and Subcontract costs, are subject to the allowability tests and requirements as set forth in the FAR (48 C.F.R Part 31), except where HHSC specifically allows an exception as documented in the Cost Principles or other Contract language. Any such exception must be specifically noted as an exception to FAR. In case of any conflicts between the Contract (including the Attachment) and FAR and/or Generally Accepted Accounting Principles, the Contract will prevail. In any case where there may be a conflict between the principles, regulations, and/or requirements of Generally Accepted Accounting Principles ("GAAP") versus those of FAR, then FAR will prevail.

Regulatory language involving a CMS exemption of applicability of FAR to Medicare will not be deemed to overrule these Cost Principles.

For purposes of applying FAR to the Contract, "at risk" will be deemed to be "Fixed Price" contracts in FAR terminology, whenever FAR distinguishes between Fixed Price and Cost Reimbursement contracts.

C. Federal disallowance/recoupment.

With respect to any payments made to the Contractor by HHSC under the Contract, if the federal government subsequently recoups money from the state for related expenses and/or costs (submitted by the Contractor) that became deemed unallowable by the federal government, the state has the right to, in turn, recoup payments made to the Contractor for these same expenses and/or costs. This applies even if such costs had not been previously disallowed by the state, and if such costs were indeed incurred by the Contractor. Any such expenses and/or costs would then be deemed unallowable by the state. If the state retroactively recoups money from the Contractor due to a federal disallowance, the state will recoup the entire amount paid to the Contractor for the specific expenses and/or costs that were federally disallowed, not just the federal portion.

D. Affiliate transactions and Affiliate cost reporting

The requirements of this section prevail over all FAR, GAAP, and any other regulatory or Contract language regarding "fair and equitable," "reasonable," or similar terms that refer to pricing between Affiliates.

For Contract cost reporting, profits made by an Affiliate due to the Contractor's Contract may not be attributed as costs to the Contract, even if the profits are reasonable. Narrowly-defined exceptions to this rule are identified in [Subsection I\(D\)\(3\)](#), "Exceptions to Affiliate cost-based

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reporting.” Any profits on the Contract made by the Contractor’s Affiliates must not be converted to a Contractor “cost” in reports submitted to HHSC.

For contract cost reporting, fees paid by the Contractor to an Affiliate are allowable only at the Affiliate’s cost, except as described in [Subsection I\(D\)\(3\)](#), below.

(1) Cost reporting requirements for Subcontractors, including Affiliates. Terms of the Attachment apply to any Subcontracts utilized by the Contractor in performing its required tasks under the Contract. Consistent with the Contractor’s affirmative duty to not include its own unallowable costs in reporting to HHSC, the Contractor is responsible for segregating any unallowable Affiliate costs for such reporting purposes. The “full cost” from an Affiliate does not generally include Affiliate profit labeled as a Contractor cost. Costs incurred by affiliated Subcontractors are subject to the same allowability tests as the Contractor’s costs, and therefore may be disallowed for cost reporting purposes.

HHSC’s right to obtain and review financial and cost documents extends to Subcontractors, including the right to (1) examine supporting documentation for cost build-up in Affiliate Subcontracts; (2) review a Subcontractor’s income statement; and (3) segregate, within the income statement, certain revenue and cost categories by those attributable to the Contract versus all other revenues and costs. At HHSC’s direction, the Contractor may be required to file a separate cost report for an affiliated Subcontractor, in order to provide further detail of Affiliate costs included and submitted by the Contractor to HHSC. Any findings by HHSC (or its auditors, if applicable) will not affect the Affiliate’s books, records, or financial reporting; such findings would only apply to the Contractor’s cost reporting to HHSC.

(2) Subcontract submission/notification: relevance to cost reporting allowability rules. Any review and/or approval of a Subcontract or Affiliate agreement by HHSC will not be construed as a determination that a cost or expense is allowable. Nor will HHSC’s review and/or approval of a Subcontract or Affiliate agreement be construed as a determination that a cost or expense is allowable under state or federal laws, rules, or regulations, or the requirements of the Contract, including these Cost Principles. Any approval by HHSC does not exempt the Subcontract from audit (if applicable); it still must conform to the Cost Principles.

Any approval of a Subcontract or Affiliate agreement by a regulatory agency other than HHSC does not overrule the terms of the Contract. For example, any approval of costs or transaction types by the Texas Department of Insurance (TDI) may be applied to the Contractor’s reporting to and compliance with TDI requirements, if any, but does not provide exemption from these Cost Principles.

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(3) Exceptions to Affiliate cost-based reporting. An exception to the rule regarding Affiliate cost reporting may occur when an Affiliate has routine sales of the item in question to multiple unaffiliated third parties, selling standard items or services (“Comparable Unaffiliated Sales”). In such cases, external prices for interchangeable items or specific services would be comparable. Examples of standard items (comparable services) include conducting a vision exam, adjudicating a claim, filling a cavity, setting a broken leg, conducting a psych diagnostic interview, etc.

This exception does not apply to parental (or other Affiliate) administrative services agreements, or to Affiliate reinsurance.

Use of the Comparable Unaffiliated Sales exception in reporting of Affiliate costs to HHSC must receive HHSC’s prior written approval. To request the Comparable Unaffiliated Sales exception for cost reporting, the Contractor must submit supporting documentation to HHSC, such as names of specific unaffiliated entities that are sold to, prices to each, timeframe, and the comparability of the services, etc., being sold and priced. To make a determination, HHSC or its designee may require the Contractor to submit information regarding sales classifications, and price lists or contracts documenting pricing details.

In contrast to the exception for Comparable Unaffiliated Sales, in most cases, an invoking of the general concept of “fair market value” or being “market priced” will not overrule the requirements regarding reporting Affiliate costs to HHSC at only the Affiliate’s cost. Fair market value will only apply to goods or services that meet all the following criteria: 1) standardized, equivalent, easily measurable and comparable; 2) bought and sold widely, by numerous unrelated third party buyers and multiple unrelated third party sellers; and 3) have a readily available independent source for comparative market pricing data. Similarly, “commercial item status” will only apply to standardized items that are readily available to buyers off-the-shelf, with prices easily discernible. The above would require situations where there are directly comparable services that are provided and sold to multiple unaffiliated third parties, and wherein the price, terms, and details of service in these third party transactions are readily apparent (or can be provided to HHSC’s satisfaction).

If a Contractor has Affiliate costs that it believes meet the criteria stated herein of either fair market value or commercial item status, it must receive HHSC’s prior written consent prior to submission of the costs to HHSC for payment. The burden is on the Contractor to demonstrate to HHSC that the criteria are met; it is not the responsibility of HHSC (or its auditor, if applicable) to develop a market comparison analysis, etc.

Conducting studies (by third party experts or otherwise) to determine an “industry range” of percentage rates to assess for corporate overhead and services, or being “within market

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standards” or “based on prevailing market terms” for pricing, etc., does not provide valid grounds to include in the cost report an Affiliate fee assessment in excess of the actual costs incurred by the Affiliate.

- (4) Affiliate vs. unaffiliated third party Subcontracts. Contractor may contract with Affiliates for various services in order to take advantage of economies of scale, potentially superior capabilities, and for other possible advantages or reasons. If the Contractor procures services outside of unaffiliated, true arm’s-length situations, then the components (i.e., the internal build-up or composition) of the subcontracted costs become subject to the Cost Principle’s allowability rules for reporting to HHSC.

Amounts paid to affiliated Subcontractors for goods and services rendered may be excluded from allowability for cost reporting purposes if they do not fall under an allowable category. Contractor costs that are unallowable in terms of cost reporting to HHSC may not become an allowable deduction by virtue of routing such costs through an Affiliate.

- (5) Administrative expense assessment “true-up.” Affiliate administrative services Subcontracts (e.g., a Subcontract with the Contractor’s parent for headquarter support functions) must be limited to allowable costs incurred by the Affiliate. In many cases, such Subcontracts may be initially paid monthly, based on a pre-determined formula, such as a percentage of the Contractor’s revenues, a per-unit-per-month amount, or a fixed flat monthly amount. When such a formula-based approach is used by an Affiliate, the Contractor must do an end-of-year “true-up” of the actual allowable charges incurred by the Affiliate, versus the amounts initially recorded on the submitted cost reports by the formula. The Contractor must modify the cost report accordingly to represent only allowable costs actually incurred by the Affiliate. Such a true-up must be done, and its impact included into the cost report, by no later than sixty calendar days after the end of each State Fiscal Year.

E. Core CMS requirements for cost allowability

In conjunction with the various specifics herein which detail allowable and unallowable costs, the Contractor must adhere to the following general principles as prescribed by the US Department of Health & Human Services’ Centers for Medicare and Medicaid Services (“CMS”), with respect to all costs submitted to HHSC hereunder:

Submitted costs must not be for efforts, services, or items that have been, should have been, or will be paid for through another federal funding source, or paid as part of a rate for direct medical services. Submitted costs must not be federally-funded under another program or contract, or used for any other federal matching purposes.

Submitted costs must not cover services or activities that are duplicated elsewhere, or should be provided by other entities, or through other programs.

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Submitted costs must not represent expenditures for general public health initiatives that are made available to all persons, such as public health education campaigns.

Submitted costs cannot include the overhead costs of operating a provider facility, or otherwise include costs of direct medical services to beneficiaries; any such costs would be deemed as medical service costs, not plan administration costs. Costs submitted hereunder must all be for administrative services costs only.

Within the context of the services rendered under the Contract, all costs submitted hereunder must be necessary for the proper and efficient administration of the Medicaid State Plan, as so deemed by CMS.

To the extent cost allocations may be utilized, and such allocations are spread among the services rendered under this Contract and other programs, then the costs must be allocated in accordance with the relative benefits received by all programs, not just Medicaid. Any cost allocation methodology utilized must be an allocation methodology included under the applicable approved public assistance cost allocation plan (reference [45 CFR 95, Subpart E](#)). The allocation methodology must conform to the accounting principles and standards prescribed in Office of Management and Budget ([OMB Circular A-87](#)), and be compatible with the State plan for public assistance programs described in [45 CFR Chapter II, III and XIII](#), and [42 CFR Chapter IV Subchapters C and D](#).

In the case of any conflicts between what costs may be deemed allowable elsewhere in this document, vs. what costs are prohibited under this subsection, this subsection shall prevail.

The Contractor must comply with all Federal statutes and regulations with respect to costs submitted hereunder. Should an audit or other review of costs submitted hereunder find non-compliance with Federal statute, regulations, protocols, or guidance, the Contractor is at risk for loss of corresponding funds paid or deemed owed hereunder.

II. Definitions

Advertising Media means magazines, newspapers, radio and television programs, billboards, bus and bench displays, banners, telephone books, outreach brochures, outreach exhibits, posters, stickers, decals, and internet advertisements. Advertising Media also includes promotional items and memorabilia, such as low-cost-per-item giveaways, souvenirs, and models.

Advertising Costs means the costs of Advertising Media and corollary administrative costs, including the Contractor's cost of events oriented specifically and narrowly at outreach to stakeholders and potential providers in Texas.

Affiliate means any individual or entity that meets any of the following criteria:

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- (1) owns or holds more than a five percent (5%) interest in the Contractor (either directly, or through one or more intermediaries);
- (2) in which the Contractor owns or holds more than a five percent (5%) interest (either directly, or through one or more intermediaries);
- (3) any parent entity or subsidiary entity of the Contractor, regardless of the organizational structure of the entity;
- (4) any entity that has a common parent with the Contractor (either directly, or through one or more intermediaries);
- (5) any entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the Contractor; or
- (6) any entity that would be considered to be an affiliate by any Securities and Exchange Commission (SEC) or Internal Revenue Service (IRS) regulation, Federal Acquisition Regulations (FAR), or by another applicable regulatory body.

Allocable Cost means a cost that is allocable to this Contract if: (a) the goods or services involved are chargeable or assignable to the Contract in accordance with relative benefits received, (b) all activities which benefit from Contractor’s indirect cost will receive an appropriate allocation of indirect costs, (c) any cost allocable to this Contract under the principles provided for in this document may not be charged to other contracts to overcome deficiencies, to avoid restrictions imposed by law or terms of such contracts, or for other reasons.

Allowable Expenses means those costs or expenses defined as allowable in these Cost Principles. A designation of “allowable” or “unallowable” does not generally govern whether the Contractor can incur a cost or make a payment; allowability only reflects what is reportable on the cost reports submitted to HHSC. To be allowable, expenses must be incurred during the Contract term by the Contractor, in connection with providing services under the requirements of the Contract; must not be reimbursable or recoverable from another source; must not be listed as an unallowable type of expense herein; and, must conform to the further requirements of these Cost Principles, which include, but are not limited to, being reasonable and allocable.

Direct Costs means those costs that can be identified specifically with and are readily assignable to the objectives of this Contract. A particular type of cost may benefit one or more other activities of Contractor, but a portion of such cost may be readily assignable to this Contract and accordingly be treated as a direct cost. For example, a particular employee may perform services that benefit more than one activity; however, if the time spent on each of the activities can be identified and distributed to those activities through a personnel activity report, the amount of the employee's compensation distributed to each activity is a direct cost for that activity. Costs that

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can be specifically identified with and assigned to the activities under this Contract are generally categorized as direct costs. However, any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such costs is consistently applied to all activities of the Contractor.

Indirect Costs means those incurred for a common or joint purpose benefiting this Contract and one or more other activities of the Contractor and are not readily assignable to the activities specifically benefited, without effort disproportionate to the results achieved. To facilitate equitable distribution of indirect expenses to the activities benefited, it may be necessary to establish a number of pools of indirect costs within the various departments of the Contractor. Indirect cost pools should be distributed to activities benefited on a basis that will produce an equitable result in consideration of relative benefits derived. For the purposes of distributing indirect cost pools to this Contract, the Contractor is not allowed to include any indirect costs in a pool so distributed which do not benefit the objectives under this Contract.

Marketing Expenses means certain marketing-related expenses that are tied to outreach efforts, and do not include certain related other costs, such as general public relations, advertising for recruitment of personnel, etc. For more specific details, see "Marketing, Advertising, and Public Relations Costs" under [Section VI](#), "Cost Categories," below.

Other Marketing Costs means a limited set of marketing costs that do not fall under the categories of Advertising Costs or Public Relations Costs.

Pre-implementation Costs – see [Subsection VI\(36\)](#), Pre-implementation Costs, below.

Public Relations Costs means the Contractor's costs of community relations and those activities dedicated to maintaining the image of the Contractor, or maintaining or promoting understanding and favorable relations with the community, public at large, or any segment of the public. This includes Contractor news releases and Contractor press releases.

Reasonable Cost means a cost that, in its nature and amount, does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining reasonableness of a given cost, consideration must be given to all of the following:

- (a) whether the cost is of a type generally recognized as ordinary and necessary for the operation of the Contractor, or the performance of the services required under this Contract;
- (b) comparable market prices for similar goods or services; this includes examination of whether other businesses similar to Contractor pay significantly less, and, whether Contractor could procure goods or services from another recognized vendor at significantly lower prices;

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(c) whether the reported cost represents more than the true net cost to the Contractor’s parent organization as a consolidated whole, after consideration of any related transactions or other factors;

(d) significant deviations from the established practices of the industry, or as compared to other companies similar to the Contractor, which may unjustifiably increase the cost incurred by the Contractor to provide the services required under this Contract;

(e) the restraints or requirements imposed by such factors as: true arms-length (non-affiliate) bargaining; whether a similar price would be paid to a different vendor who was not related to the Contractor; the presence of any retrocession or similar agreements with the vendor or an affiliate of the vendor; the impact or influence of other business that the Contractor or one of Contractor’s Affiliates may have with the vendor or an affiliate of the vendor; sound business practices; Federal, State and other laws and regulations; the terms and conditions of this Contract; and,

(f) whether the individuals concerned acted with prudence in the circumstances, and in an ethical, forthright manner that would bear public scrutiny, considering their responsibilities to the Contractor, its employees, taxpayers, and the State of Texas.

To be allowable, a “reasonable” cost still must meet other Cost Principles requirements, especially with respect to Affiliate transactions. Being “reasonable” is not sufficient, in and of itself, to be allowable.

Subcontract means any written agreement between the Contractor and another party, including an Affiliate, to fulfill certain requirements of the Contract.

Subcontractor means any individual or entity, including an Affiliate, which has entered into a Subcontract with the Contractor.

III. Applicable Credits

Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items attributed to this Contract. Examples of such transactions are: purchase discounts; rebates or allowances; recoveries or indemnities on losses; insurance refunds or rebates; and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the Contractor relate to allowable costs, they must be credited to this Contract either as a cost reduction or an increase in revenues, as appropriate.

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IV. Composition of Administrative Costs

The total administrative expenses of this Contract are comprised of the allowable direct costs of the work on the Contract, plus the allocable portion of allowable indirect costs, less applicable credits. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function of the Contractor but indirect with respect to the objectives under this Contract. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost.

Fees based on profitability. Between affiliated entities, variable fees (or cost rates) that are dependent on the *level* of profitability are unallowable, except when HHSC grants a specific written exception, which will only be granted when it is in the best interest of HHSC and/or its constituents. Any Contractor desiring such an exception must submit a formal written request, demonstrating the reasonableness, the clear benefit to the Contract, the proposed methodology, and the financial implications.

V. Allocation of Indirect Costs

Unless specifically allowed by HHSC, indirect costs that are assessed or allocated by a parent company or Affiliate to the relevant operating subsidiary are only allowable to the extent that: (a) the costs clearly represent specifically identified operating services provided for the operating subsidiary; and (b) such services directly benefit HHSC and/or its clients/customers (e.g., Medicaid or CHIP members).

These specifically identified and directly beneficial services would include core operating functions (e.g., centralized accounting, billing, IT, etc.), but would not include or allow items such as: vague management allocations where there is no clear and direct identifiable benefit to the contract, or fees that are assessed in addition to total (direct and indirect) costs, or overhead expenditure levels deemed clearly unreasonable (e.g., travel by private jet). During any audit verification or prospective contract review, expenditures must be broken out separately by function and meet the test of reasonability, and other requirements described in these Cost Principles.

The Contractor must develop and retain a written allocation methodology policy prior to the submission of any costs based on the allocation. The allocation methodology must be forwarded to HHSC upon request; it may be reviewed in the course of any audit, and must allocate costs in a manner deemed appropriate by HHSC and/or its auditor.

See also “Administrative Expense ‘true-up’” and other portions of [Section I\(D\)](#) above.

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VI. Cost Categories

1. Accounting. The cost of establishing and maintaining accounting and other information systems is allowable.
2. Add-on Fees. Amounts paid to an Affiliate that are in excess of actual costs incurred by the Affiliate, or that do not represent a pass-through of the actual costs of the Affiliate, are unallowable for cost-reporting to HHSC. This includes profit, margin, or mark-ups added to, or included in, Affiliate costs. Certain exceptions may apply; see [Subsection I\(D\)\(3\)](#), “Exceptions to Affiliate cost-based reporting.”
3. Administrative Assessments. Certain parent company cost assessments for various administrative services provided to the Contractor are allowable. However, any administrative services fees paid to, or assessed by, a parent or other Affiliate, which are unsupported in terms of actual documented specific allowable costs incurred by the Affiliate, are unallowable for cost-reporting to HHSC.
4. Advisory Councils. Costs incurred by advisory councils or committees are allowable only as a direct cost and only where specifically approved in advance by HHSC.
5. Alcoholic Beverages. Costs of alcoholic beverages are unallowable.
6. Audit Services. The costs of audits are allowable provided that the audits were performed in accordance with Generally Accepted Auditing Standards promulgated by the American Institute of Certified Public Accountants.
7. Automatic Electronic Data Processing. The cost of data processing services is allowable.
8. Bad Debts. Any losses arising from uncollectible accounts and other claims, and related costs, are unallowable unless approved in advance by HHSC.
9. Bonding Costs. Costs of bonding employees and officials are allowable to the extent that such bonding is in accordance with sound business practice.
10. Bond issuance cost amortization. Amortization of the costs involved in issuing bonds is unallowable. Similarly, bond discounts and other costs of financing are also unallowable.
11. Budgeting. Costs incurred for the development, preparation, presentation, and execution of budgets are allowable.
12. Capital expenditures and capital investment. Expenditures or investment for equipment or buildings, and/or repairs that materially increase the value or useful life of buildings or equipment, should be capitalized, and are unallowable, in terms of being totally expensed

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when initially incurred. Depreciation of these capital expenditures, in accordance with Generally Accepted Accounting Principles (GAAP) or the Federal Acquisition Regulations (FAR), may be *allowable when* it can be clearly shown that the depreciation is *directly tied to, and in support of, the specific functions* and tasks required and performed under the Contract (see [Subsection IA](#), Costs limited to specific functions, above). See also [Subsection VI\(19\)](#), Depreciation and Amortization, below.

13. Communications. Costs of telephone, mail, messenger, and similar communication services are allowable.
14. Compensation for Personnel Services.
 - a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under this Contract, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this document, and that the total compensation for individual employees:
 1. Is reasonable for the services rendered and conforms to the established policy of the Contractor, consistently applied to all of its activities;
 2. Follows an appointment made in accordance with an the Contractor's policies, and meets merit system or other requirements required by Federal law, where applicable; and
 3. Is determined and supported as provided in [Subsection VI\(14\)\(h\)](#), Support of Salaries and Wages.
 - b. Reasonableness of compensation. Compensation for employees engaged in work on this Contract will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the Contractor. In cases where the kinds of employees required for this Contract are not found in the other activities of the Contractor, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the Contractor competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.
 - c. Unallowable Compensation-related Costs. Costs that are unallowable under other Sections of these Cost Principles will not be allowable under this Section solely on the basis that they constitute personnel compensation.

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d. Fringe benefits.

1. Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable or are required by law.
2. The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, vacation, sick leave, holidays, court leave, military leave, maternity leave, and other similar benefits, are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all of the related activities of the Contractor; and (c) the basis of accounting utilized for costing each type of leave is consistently followed by the Contractor.
3. The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When the Contractor uses the accrual basis of accounting in accordance with GAAP and complies with the other provisions of this Article, leave costs are allowable.
4. The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in [Section VI\(28\)](#), "Insurance and Indemnification"); pension plan costs (see [Subsection VI\(14\)\(e\)](#)); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, whether treated as indirect costs or as direct costs, must be allocated to this Contract and all other activities of the Contractor in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to this Contract and such other activities.

e. Pension Plan Costs. Pension plan costs may be computed using an acceptable actuarial cost method recognized by GAAP in accordance with established written policies of the Contractor.

1. Pension costs calculated using an actuarial cost-based method are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six-month period (or a later period agreed to by HHSC) are allowable in the year funded.

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2. Amounts funded by the Contractor in excess of the actuarially determined amount for a fiscal year may be used as the Contractor’s contribution in future periods.
 3. This Contract must receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the Contractor in the form of a refund, withdrawal, or other credit.
- f. **Post-Retirement Health Benefits.** Post-retirement health benefits (“PRHB”) refers to costs of health insurance or health services not included in a pension plan covered by [Subsection VI\(14\)\(e\)](#) for retirees and their spouses, dependents, and survivors. PRHB costs may be computed using an acceptable actuarial cost method recognized by GAAP in accordance with established written policies of the unit.
1. PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six-month period (or a later period agreed to by HHSC) are allowable in the year funded.
 2. Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the Contractor’s contribution in a future period.
 3. To be allowable in the current year, the PRHB costs must be paid either by:
 - (a) The Contractor or other benefit provider as current year costs or premiums, or
 - (b) The Contractor or trustee to maintain a trust fund or reserve for the sole purpose of providing post-retirement benefits to retirees and other beneficiaries.
 4. This Contract must receive an equitable share of any amounts of previously allowed post-retirement benefit costs (including earnings thereon) that revert or inure to the Contractor in the form of a refund, withdrawal, or other credit.
- g. **Severance Pay.**
1. Payments in addition to regular salaries and wages made to workers whose employment is being terminated are *unallowable*.
 2. Severance payments associated with normal turnover are *unallowable*.
 3. Abnormal or mass severance pay is *unallowable*.
- h. **Support of Salaries and Wages.** These standards regarding time distribution are in addition to the standards for payroll documentation.

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1. Charges to this Contract for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the unit and approved by a responsible official(s) of the Contractor.
2. No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.
3. Where employees are expected to work solely on a single contract, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that contract for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.
4. Where employees work on multiple activities (i.e., not all of a specific employee's work effort is dedicated to the Contract), a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation that meets the standards in [Subsection VI\(14\)\(h\)\(5\)](#) unless a substitute system has been approved by HHSC. Such documentary support will be required where employees work on multiple activities, wherein some activities fall within, and some outside, the scope of the Contract.
5. Personnel activity reports or equivalent documentation must meet the following standards:
 - (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
 - (b) They must account for the total activity for which each employee is compensated,
 - (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
 - (d) They must be signed by the employee.

Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to this Contract but may be used for interim accounting purposes, provided that:

- (a) The Contractor's system for establishing the estimates produces reasonable approximations of the activity actually performed; and

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(b) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made and adjustments to actual costs are recorded.

6. Substitute systems for allocating salaries and wages to this Contract may be used in place of activity reports. These systems are subject to approval by HHSC.

i. Employee Bonuses or Incentive Payments.

1. Employee bonuses are *unallowable*.

2. Bonuses paid or payable to an Affiliate are unallowable.

15. Contingencies. Contributions to a contingency reserve or any similar provision, which is created to cover the costs of events or occurrences that cannot be foretold with certainty as to time, or intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see [Subsection VI\(28\)\(d\)](#)), pension plan reserves (see [Subsection VI\(14\)\(e\)](#)), and post-retirement health and other benefit reserves (see [Subsection VI\(14\)\(f\)](#)) computed using acceptable actuarial cost methods.

16. Contributions and Donations. Contributions and donations, including cash, property, and services, regardless of the recipient, are unallowable.

17. Cost of capital. Expenses representing the cost of capital in any manner are unallowable.

18. Defense and Prosecution of criminal proceedings, civil proceedings, and claims are generally unallowable.

a. An exception exists for a Contractor to identify, investigate and/or pursue recoveries relating to suspected Fraud, Abuse or Waste (as such terms may be defined in the Contract) of providers or unaffiliated Subcontractors providing services, wherein the costs for such services are incorporated, directly or indirectly, into one or more HHSC contracts, as well as to assist with the prosecution of suspected Fraud, Abuse or Waste with such providers or unaffiliated subcontractors. This exception includes reasonable associated costs incurred in:

1. identifying, investigating and/or pursuing such Fraud, Waste, or Abuse that could impact the reported costs in HHSC contracts,
2. any related cooperation with and/or assistance provided to any state or federal agency regarding such matters; and
3. defense costs that arise as a result of such actions against providers and unaffiliated subcontractors.

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Costs incurred under this exception do not have to result in actual recoveries in order to qualify.

- b. An exception exists for reasonable legal costs related to subrogation, third party recoveries, and provider credentialing matters, which are allowable if such costs are incurred directly in the administration of the Contract with HHSC.

No exception hereunder extends to the payment by the Contractor, or any Affiliate, of any fines, penalties, settlements, imposed court costs or attorney fees, sanctions, damages, interest, or related types of expenses. The costs of any such fines, penalties, etc., are unallowable.

In no case are legal or related costs allowable for prosecution of claims against a state or the Federal government or other governmental body; or in connection with any criminal, civil, or administrative proceeding commenced by a state or Federal government or any other governmental body.

19. Depreciation and Amortization.

- a. Depreciation and amortization are a means of allocating the cost of fixed assets and intangible assets to periods benefiting from asset use. Depreciation for a particular class of assets (e.g., buildings, office equipment, computer equipment, etc.) and amortization for a particular class of assets (e.g., patents, leasehold improvements, etc.) charged to this Contract must be determined on the same basis used for the entity-wide financial statements. Depreciation, in accordance with Generally Accepted Accounting Principles (GAAP) or the Federal Acquisition Regulations (FAR), may be *allowable when* it can be clearly shown that the depreciation is *directly tied to, and in support of, the specific functions* and tasks required and performed under the Contract (see [Subsection IA](#), Costs limited to specific functions, above).
- b. The computation of depreciation must be based on the acquisition cost of the assets involved, for acquisitions from non-affiliates. The computation must be based on the fair-market value at the time of acquisition, for acquisitions from Affiliates. The value of an asset donated to the Contractor must be its fair market value at the time of donation.
- c. Charges for depreciation and amortization must be supported by adequate property records, including the amount of depreciation and amortization taken each period.
- d. Charges for amortization of intangible assets are allowable only to the extent that they represent direct costs for the acquisition of proprietary processes (patents, copyrights, etc.) to be used exclusively in fulfilling the objectives of this Contract. Charges for amortization of intangible assets not related to proprietary processes, such as goodwill

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and debt acquisition costs, are unallowable. Charges for amortization of intangible assets acquired from Affiliates are unallowable.

20. Employee Health and Welfare Costs. The costs of health or first-aid clinics and/or infirmaries, employee counseling services, employee information publications, and any related expenses incurred in accordance with the Contractor’s policy are allowable. Income generated from any of these activities will be offset against expenses.
21. Entertainment. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.
22. Fines and Penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the unit to comply with, Federal, State, or local laws and regulations, are unallowable except when incurred as a result of compliance with specific provisions of this Contract or written instructions by HHSC authorizing such payments in advance.
23. Income taxes. Federal, state, and local taxes on income are unallowable. This includes excess profit taxes, corporate income taxes paid by a parent, and any other income taxes paid by a parent or other Affiliate.
24. Investment Management Costs. Costs of investment counsel and staff and similar expenses incurred to enhance income from investments are unallowable.
25. Liquidated Damages paid to the Health and Human Services Commission are unallowable.
26. Losses on Disposition of Depreciable Property and other capital assets are unallowable.
27. Idle Facilities and Idle Capacity.
 - a. As used in this Section the following terms have the meanings set forth below:
 1. Facilities means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the Contractor.
 2. “Idle facilities” means completely unused facilities that are excess to the Contractor’s current needs.
 3. Idle capacity means the unused capacity of partially used facilities. It is the difference between (a) that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and (b) the extent to which the

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facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

4. Cost of idle facilities or idle capacity means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, and depreciation or use allowances.

b. The costs of idle facilities are unallowable.

28. Insurance and Indemnification.

- a. Costs of insurance required or approved and maintained, pursuant to this Contract are allowable.
- b. Costs of other insurance in connection with the general conduct of activities are allowable if the types and extent and cost of coverage are in accordance with the Contractor's policy and sound business practice.
- c. Actual losses that could have been covered by permissible insurance (through a self-insurance program or otherwise) are unallowable, unless expressly provided for in this Contract or as described below. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools which occur in the ordinary course of operations, are allowable.
- d. Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:
 1. The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, must not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the settlement rate for those liabilities and its investment rate of return.
 2. Earnings or investment income on reserves must be credited to those reserves.
 3. Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and



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updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverage will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be identified and justified in the cost allocation plan or indirect cost rate proposal.

4. Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If the Contractor experiences significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.
5. Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds must be made to HHSC for its share of funds transferred, including earned or imputed interest from the date of transfer.
- e. Actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (e.g., post retirement health benefits), are allowable in the year of payment provided (1) the Contractor follows a consistent costing policy, and (2) they are allocated as a general administrative expense to all activities of the Contractor.
- f. Insurance refunds must be credited against insurance costs in the year the refund is received.
- g. Indemnification includes securing the Contractor against liabilities to third persons and other losses not compensated by insurance or otherwise. HHSC is obligated to indemnify the Contractor only to the extent expressly provided for in this Contract.
29. Interest. In general, interest expense is unallowable. This includes interest expense incurred by a parent or other Affiliate. Costs incurred for interest on borrowed capital or the use of the Contractor's own funds, however represented, are unallowable, except as provided in [Subsection VI\(41\)\(d\)](#) (regarding rental costs for certain leases). Interest expense incurred by a parent or other Affiliate may not be incorporated into an overhead assessment and included in costs assessed to the Contractor.
30. Lobbying. The cost of activities associated directly or indirectly with influencing local, state, or Federal legislation is an unallowable cost.

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31. Maintenance, Operations, and Repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. Costs that add to the permanent value of property or appreciably prolong its intended life must be treated as capital expenditures (see [Subsection VI\(12\)](#), Capital expenditures, above).

32. Marketing, Advertising, and Public Relations Costs.

a. Applicability

This Subsection describes the limited cost allowability (with respect to potential inclusion in the cost reports submitted to HHSC) for advertising, marketing, promotional, outreach, and public relations activities (collectively “marketing activities”) for expenditures that a Contractor may incur. For rules concerning *permissible* marketing activities, refer elsewhere, to the relevant portion of the Contract. Note that it is possible that a marketing activity may be permissible under Contract, but not an allowable expense for purposes of cost reporting. A communication from HHSC regarding what specific marketing practice may be permitted does not over-ride the rules in this Section regarding the allowability of expenses.

This Subsection describes the costs allowable for inclusion in cost reports submitted to HHSC.

b. Costs That Are Allowable as Marketing Expenses in the cost reports.

The following costs are allowable as deductible expenses in the cost reports, subject to the limitations as listed under [Subsection VI\(32\)\(d\)](#), Unallowable Marketing-related Costs, below. Contractor should record the following costs on the Marketing Expenses line item in the HHSC cost reports:

1. Advertising Costs, when incurred by the Contractor for outreach efforts, if all three of the following criteria are met:
 - (i) the expense is incurred by the Contractor in its role as an Anchor hereunder, and would not have otherwise been incurred;
 - (ii) the advertising (and related activity) is not in violation of other parts of the Contract which govern those activities that are permissible; and

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- (iii) the primary target audience consists of relevant providers and stakeholders in the Anchor’s region within Texas.
2. Other Marketing Costs, when incurred by the Contractor for the following items:
- (i) provider or stakeholder surveys;
 - (ii) provider or stakeholder focus groups and advisory committees;
 - (iii) materials and/or events oriented specifically at provider or stakeholder education;
or
 - (iv) reasonable payments for booth rentals at events attended by the Contractor for provider and/or stakeholder outreach purposes, which events are attended by stakeholders and/or prospective Texas providers.
- c. Related Costs That Are Allowable on HHSC cost reports, But Not as Marketing Expenses.
- The following costs are allowable as deductible expenses on HHSC cost reports, subject to the limitations as listed under [Subsection VI\(32\)\(d\)](#), “Unallowable Marketing-related Costs,” but should NOT be recorded on the Marketing Expenses line item on HHSC cost reports.
1. Mailing and printing costs for correspondence with current providers and/or stakeholders. These items are not considered to be Marketing Expenses, unless a specific effort is primarily oriented towards provider retention or provider renewal. Allowable costs associated with these items should be recorded in the same manner described above for directories, provider manuals, and handbooks.
 2. Certain non-marketing Advertising Costs, when incurred by the Contractor for:
 - (i) the recruitment of personnel to perform services for the Contract;
 - (ii) the procurement of directly-related goods and services for the Contract;
 - (iii) the disposal of any directly-related surplus materials directly by the Contractor; or
 - (iv) certain limited other cases, where the incurrence of Advertising Costs are necessary to meet the requirements of the Contract with HHSC.

Such non-marketing Advertising costs should be recorded as Other Administrative Expenses.
 3. Public Relations Costs incurred by the Contractor as a direct, non-allocated cost for public relations (“PR”) activities are allowable in the following circumstances:
 - (i) any PR activities that may be required by the Contract with HHSC; and

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- (ii) costs related to the Contract with HHSC that are incurred to respond to inquiries on the Contractor’s policies and activities with respect to its duties and requirements under the Contract.

Any valid such Public Relations costs should be recorded in cost reports submitted to HHSC on appropriate line items similar to as described under website hosting costs, below.

- 4. Basic website costs, including home-site hosting, site maintenance, etc., *if such items are directly related to the Contractor’s role as Anchor hereunder, and would not have been incurred otherwise.* These items are not considered to be Marketing Expenses, unless the cost is dedicated to the procurement of internet advertising. Hosting and maintenance should be recorded under Salaries for that portion that represents in-house efforts, and to Outsourced Services for appropriate external fees, and otherwise to Other Administrative Expenses.

Note that any other related marketing and advertising type costs that are allowable per these Cost Principles and FAR, but excluded from being reported on the Marketing Expense line, should be reported in cost reports submitted to HHSC under Other Administrative Expenses if the Contractor determines that no other line item is appropriate.

d. Unallowable Marketing-related Costs

Advertising Costs, Public Relations Costs, and Other Marketing Costs that are not allowable expenses in cost reports submitted to HHSC include the following:

- 1. Any media or efforts that are not directly tied to the Contractor’s role as an Anchor hereunder. Likewise, any media or efforts that would have occurred even if Contractor had not taken on the duties and requirements under the Contract.
- 2. Any activity that is not in compliance with the Contract.
- 3. Any costs associated with any of the following:
 - (i) any written or oral statements containing material misrepresentations of fact or law, or that are in any manner determined by HHSC to be significantly misleading;
 - (ii) usage of “spam,” (i.e., unwanted commercial messages sent via email, text message, etc.);
 - (iii) materials used or efforts directed, in whole or in part, at anything unrelated to the Contract;



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- (iv) activities outside the State of Texas;
 - (v) royalty fees or franchise fees;
 - (vi) gifts or gratuities;
 - (vii) charitable donations of any kind, including cash contributions to non-profit organizations, and paid sponsorships;
 - (viii) Value-Added Services, which is to say, costs associated with providing additional services beyond those specified and required in the Contract;
 - (ix) the costs of conventions, retreats, gatherings, parties, awards presentations, appreciation events, celebrations, entertainment, non-outreach activities, internal meetings, or events related to internal activities of the Contractor or its Affiliates;
 - (x) expenses related to events described in [Subsection VI\(32\)\(d\)\(3\)\(ix\)](#) immediately above, including costs associated with displays, demonstrations, and exhibits; costs of meeting rooms and hospitality suites; and any related airfare, lodging, meals, car rental, fuel, taxi, mileage, parking, laundry, entertainment, and other travel expenses;
 - (xi) unsolicited direct mail to members of the public; cold-calling; door-to-door marketing; or acquisition or development of mailing lists to private citizens;
 - (xii) fees (including assessments, allocations, overhead, or other charges) invoiced from a parent organization (or other Affiliate), for any advertising related costs, public relations related costs, or other marketing expenses. An exception to this would be where any such costs pertain directly and solely to the Contract, and represent only the direct net external payment to an unaffiliated third party.
4. Costs of memberships in civic or community organizations, including dues and expenses associated with country club and fraternal organizations.
 5. Political contributions or costs associated with lobbying, and any costs associated with elected officials or candidates.
 6. Any costs or activities that are not in compliance with the Federal Acquisition Regulations (FAR), including 42 C.F.R. 438.104.
 7. Certain other costs which may be allowable under other HHSC contracts, but are not allowable hereunder, including:
 - (i) non-cash promotional items and giveaways;

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- (ii) Public Relations Costs, advertising, or other costs, when such costs are incurred to communicate with the public and press, including costs incurred to conduct general communication with news media;
- (iii) costs of Contractor participation in community service activities (e.g., blood bank drives, charity drives, disaster assistance, etc.);
- (iv) costs of professional and industry organizations, associations, and periodicals, including memberships, subscriptions, meeting costs, and associated dues, fees, contributions, reimbursements, etc.; and,
- (v) Marketing-related and Public Relations related overhead allocations (or assessments), from a parent (or other Affiliate). An exception to this disallowance would be for a cost that solely represents a direct net payment to an unaffiliated third party, wherein the payment is specifically for advertising which would have otherwise been allowable herein, had it been paid directly by the Contractor.

33. Materials and Supplies. The cost of directly-related materials and supplies is allowable *if such items are directly related to the Contractor's role as Anchor hereunder, and would not have been procured otherwise.* Purchases should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing, consistently applied. Incoming transportation charges are a proper part of materials and supply costs.

34. Memberships, Subscriptions, and Professional Activities.

The following costs are allowable *if such items are directly related to the Contractor's role as Anchor hereunder.* Any expenditure within this Subsection that might be utilized for both an Anchor function and also some other business of the Contractor should be appropriately pro-rated.

- a. Costs of the Contractor's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the Contractor's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals, transportation, rental of meeting facilities, and other incidental costs are allowable, subject to the limitations of [Subsection VI\(47\)](#), "Travel Costs."

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d. Costs of membership in civic and community social organizations are allowable as a direct cost only with the advance written approval of HHSC.

Costs of membership in organizations substantially engaged in lobbying are unallowable.

35. Motor Pools. The costs of a service organization that provides automobiles to the Contractor at a mileage or fixed rate and/or provides vehicle maintenance, inspection, and repair services are allowable *if such items are directly related to the Contractor's role as Anchor hereunder, and would not have been procured otherwise*.

36. Pre-implementation Costs. Pre-implementation costs are certain costs incurred between the date of tentative Contract award, and the Operational Date of the Contract (i.e., the date the first Contract services are commenced). *Pre-implementation costs are unallowable*.

Note that costs incurred prior to the notification of Contract award, which may be incurred in anticipation of the award of the Contract, or in connection with Contract negotiations, bid preparation, or RFP submission, etc., are also unallowable.

37. Professional Service Costs.

a. Professional services costs are the cost of professional and consultant services rendered by persons or organizations that are members of a particular profession or possess a special skill. Costs of professional and consultant services are allowable if they meet all of the following:

are rendered by such persons who are not directors, officers or employees of the Contractor, or are rendered by a person related by family to a director, officer, or employee of the Contractor;

are rendered by such organizations who are not owned (5% or more) or controlled, directly or indirectly, by one or more directors, officers or employees of the Contractor, or are owned or controlled by a person related by family to a director, officer, or employee of the Contractor;

are reasonable in relation to the services rendered;

are not contingent upon recovery of the costs from HHSC; and

do not conflict with any other provisions of these Cost Principles.

b. Retainer fees supported by evidence of bona fide services available or rendered are allowable.

38. Proposal Costs. Costs of preparing proposals (responses to RFPs, etc.) for potential contracts are unallowable.

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39. Publication and Printing Costs. Publication costs, including the costs of printing (including the processes of composition, plate-making, presswork, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling are allowable.
40. Rebates and profit sharing. Unless specifically allowed by the HHSC contract, any profit sharing or rebate arrangement between the Contractor and a subcontractor is unallowable. Likewise, any fees or assessments between the Contractor and an Affiliate company, which are not tied to specifically identified services that directly benefit the Contract, such that the fee is effectively a form of profit payment or rebate to the Affiliate, are unallowable unless specifically identified and allowed by the Contract.
41. Rental Costs.
- a. Subject to the limitations described in [Subsections VI\(41\)\(b\)](#) through 41(d) of this Section (immediately below), rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.
 - b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the Contractor continued to own the property.
 - c. Rental costs under Affiliate or other less-than-arms-length leases are allowable only up to the amount that would be allowed had the property been rented to the Contractor by a true unaffiliated third party. For this purpose, less-than-arms-length leases include, but are not limited to, those where:
 1. One party to the lease is able to control or substantially influence the actions of the other.
 2. Both parties are parts of the same parent company, or are otherwise Affiliates.
 3. The Contractor, or an Affiliate of the Contractor, creates or utilizes an affiliated entity to acquire and lease the facilities to the Contractor (and possibly to other parties).
 - d. Rental costs under leases required to be treated as capital leases under GAAP are allowable only up to the amount that would be allowed had the Contractor purchased the property on the date the lease agreement was executed. This amount would include expenses such as depreciation, interest, maintenance, and insurance. The provisions of Financial Accounting Standards Board Statement 13 must be used to determine whether a lease is a capital lease.

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42. Retrocession Agreements. “Retrocession” refers to a transaction whereby a reinsurer cedes or transfers back to the insured or its designee all or part of the reinsurance that the reinsurer previously assumed. Thus, while the reinsurer is “providing” ongoing reinsurance to the insured in one contract, it is simultaneously relieving itself of all or part of that reinsurance obligation in another contract. In conjunction with this transfer of risk away from the reinsurer, a retrocession agreement may involve the return of reinsurance premiums back to the insured or its designee, or the remitting of other payments from the reinsurer to the insured or its designee, that have the effect of substantially offsetting or reducing the gross amount that had been paid to the reinsurer by the insured in the original reinsurance.

Any retrocession agreement that would impact cost reporting to HHSC and that fails to strictly meet the requirements of these Cost Principles prior to audit may be deemed a material breach of the Contract. A retrocession agreement may be permissible under the Contract only if it meets all the criteria listed below.

Any retrocession payments made by a reinsurer or its Affiliate that are related in any manner to the costs incurred or services performed under the Contract, and which payments are or may be received by the Contractor or an Affiliate, must be included in the cost reports submitted to HHSC as a “contra-cost,” or an offset to other reported costs, thus reducing overall expenses reported. Any retrocession payments that are contractually required due to activity in a given State Fiscal Year (SFY) must be reported in that SFY’s cost reporting, even if the payments are not received until a subsequent SFY. Retrocession agreements may not be utilized to shift reported profitability either between years or out of the Contractor.

Copies of all retrocession agreements relating to the Contractor’s submitted costs for performance under the Contract must be sent to HHSC, including any amendments or renewals. Such retrocession agreements, amendments, and renewals must receive HHSC’s prior written approval. These requirements also apply to any retrocession agreement (or payment) between an Affiliate and a third party, if such agreement (or payment) would affect the reported cost on the cost reports submitted to HHSC. These requirements apply to any “interests and liabilities contract” associated with any reinsurance agreement; “excess of loss reinsurance binder;” reinsurance-related “experience refunds;” and other arrangements that may affect similar mechanisms. These requirements also apply to any agreement or arrangement with a third party that wholly or partially negates, or significantly offsets, any reinsurance with the third party or any of its affiliates.

43. Risk Mitigation. Risk mitigation refers to the shifting of financial risk to another entity, in exchange for a payment. For purposes of cost reporting to HHSC, a reinsurance arrangement will be considered to have accomplished “risk mitigation” only to the extent that the

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arrangement shifts risk to a non-Affiliate. Further, any retrocession arrangements may have the effect of cancelling all or part of the risk mitigation.

44. Royalty Agreements (including associated fees, payments, expenses, and premiums). Payments to an Affiliate for any form of royalty are unallowable. This includes, but is not limited to, fees, payments, expenses, premiums, assessments, and overhead allocations to recognize the advantage or value of proprietary systems, business products, processes, and methodologies; intellectual property; brand name recognition; logos; experience and expertise; and ability to raise capital. Costs for these items are unallowable, regardless of whether they are labeled as royalty payments.
45. Taxes.
 - a. Income taxes and State franchise taxes are unallowable. In general, other taxes that the Contractor is legally required to pay are allowable.
 - b. Gasoline taxes, motor vehicle fees, and other taxes that are effectively user fees for benefits (such as the usage of highways) provided by the government are allowable.
 - c. Applicable Premium taxes and Maintenance taxes are an allowable charge to the Contract.
 - d. This provision does not restrict the authority of the State to identify taxes where participation by the State is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the State may accept a reasonable approximation thereof.
46. Training. The cost of training provided for employee development is allowable.
47. Travel costs.
 - a. General. Travel costs are allowable only as a direct cost for expenses for transportation, lodging, subsistence, and related items incurred by employees traveling on official business specifically related to the Contract. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in all other activities of the Contractor.
 - b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, will be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the Contractor in its regular operations as a result of the Contractor 's policy. In the absence

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of a written policy regarding travel costs, the rates and amounts of travel will be allowed only as part of a plan submitted in advance to HHSC.

- c. Commercial air travel. Airfare costs in excess of the customary standard (coach or equivalent) airfare are unallowable. Such costs are unallowable even if they conform to the Contractor’s written policy regarding travel costs.
- d. Air travel by other than commercial carrier. Cost of travel by Contractor -owned, -leased, or -chartered aircraft, as used in this Section, includes the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, interest, insurance, and other related costs. Costs of travel via Contractor -owned, -leased, or -chartered aircraft are unallowable to the extent they exceed the cost of allowable commercial air travel, as provided for in [Subsection VI\(47\)\(c\)](#), immediately above.

VII. Other Costs

Failure to mention a particular item of cost in this document is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each case should be based on the treatment or standards provided for similar or related items of cost. To be allowable as expenses under this Contract, costs must meet the following general criteria:

- a. Be a reasonable cost under the provisions of this Contract and be necessary for proper and efficient performance and administration of this Contract.
- b. Be an allocable cost under the provisions of this Contract.
- c. Be authorized or not prohibited under state or local laws or regulations.
- d. Conform to any limitations or exclusions set forth in these principles, terms and conditions of this Contract, laws, or other governing regulations as to types or amounts of cost items.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both this Contract and other activities of the Contractor.
- f. Be accorded consistent treatment. A cost may not be assigned to this Contract as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to this Contract as an indirect cost.
- g. Except as otherwise provided for in this Contract, be determined in accordance with Generally Accepted Accounting Principles.
- h. Not be included as a reimbursable cost or used to meet cost sharing requirements of any other activity of the Contractor during the Contract term.

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- i. Be net of all applicable credits.
- j. Be adequately documented.
- k. Affiliate costs must meet the same allowability requirements as those for the Contractor.
Other than the exceptions described in [Subsection I\(D\)](#), Affiliate costs must represent a pass-through of actual costs incurred by the Affiliate, with no mark-up, and must consist solely of allowable costs under these Cost Principles.

Any legal commitments to make any payments to other parties (or any actual payments made to other parties) do not overrule the requirements described in these Cost Principles. Even though a payment was made, and a Subcontract made that payment legally required, that cost may not be included in cost reports submitted to HHSC unless it is allowable under these Cost Principles.