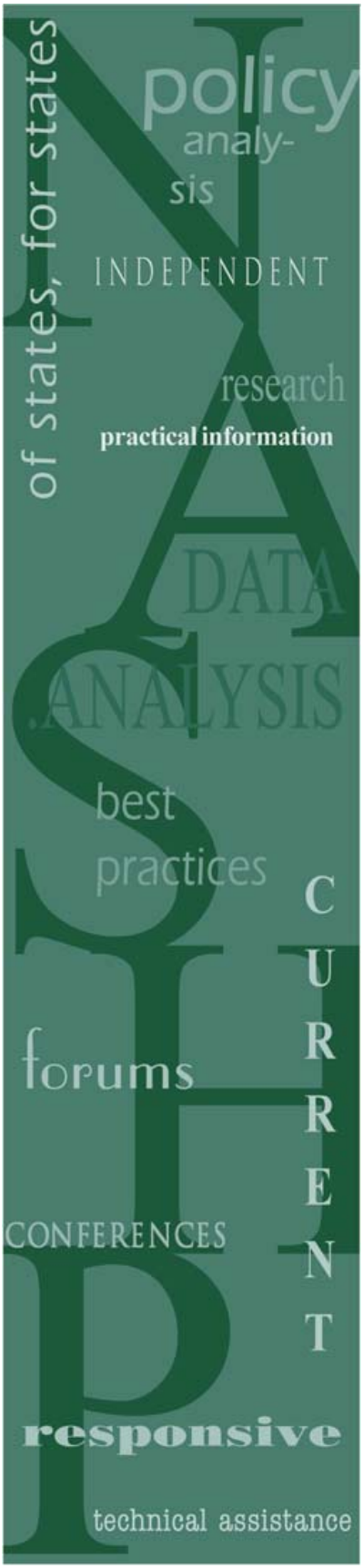

NATIONAL ACADEMY *for* STATE HEALTH POLICY

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Summary Brief – Moving Beyond the Tug of War: Improving Medicaid Fiscal Integrity

BACKGROUND

For at least the last twenty-five years, state governments and federal regulators have been involved in a high-stakes struggle about how Medicaid programs are financed. From the states' perspective, financing guidelines have become even murkier in recent years. In order to serve certain federal policy goals, the federal government has allowed and even encouraged state fiscal practices that it later rules impermissible. The Centers for Medicare & Medicaid Services (CMS) has made decisions for individual states that seemed inconsistent. From the federal perspective, states are engaged in a constant game of "catch-me-if-you-can" in an effort to maximize receipt of federal matching funds. Once states implement these efforts, their Congressional delegations often oppose efforts to undo them, no matter how egregious the practices may appear. This cycle of action and response has been repeated many times in the last 20 years, each time poisoning the critical intergovernmental relationship necessary for successful delivery of health services to our poorest citizens.

The goal of the NASHP fiscal integrity project was to explore the issues, find common ground, and generate ideas for further analysis related to improving Medicaid fiscal integrity. NASHP convened a diverse Medicaid Fiscal Integrity Work Group on November 1, 2005, in Washington, DC. Views expressed in this report are NASHP's, rather than a consensus of the group.

This brief is a summary of *Moving Beyond the Tug of War: Improving Medicaid Fiscal Integrity*, by Sonya Schwartz, Shelly Gehshan, Alan Weil, and Alice Lam, published by the National Academy for State Health Policy, August 2006. The full report is available at: http://www.nashp.org/Files/Medicaid_Fiscal_Integrity.pdf. Development of the report was supported by The Robert Wood Johnson Foundation. The views presented here are those of the authors and not necessarily those of the Robert Wood Johnson Foundation, its directors, officers, or staff.

What is Fiscal Integrity in Medicaid?

Fiscal integrity in Medicaid means a fiscal relationship between the states and the federal government that is sound. Integrity has a moral meaning; fiscal integrity in Medicaid implies a standard of appropriateness from the perspective of both parties to the relationship. Fiscal integrity boils down to two components. First, every dollar paid should be for a person, for a service, and at a price that is defensible. Second, there should be no virtual or illusory transactions – state and federal contributions for their share of the program should be real.

WHAT WOULD FISCAL INTEGRITY IN THE MEDICAID PROGRAM LOOK LIKE?

Clear Rules from the Federal Government, Applied Equally

Participants agreed that clear federal rules about fiscal integrity that are fair to the federal government and states are needed to guide their fiscal practices. Clear, fair federal rules would help states comply with federal law, and protect states from hardship that could be caused by retrospective disallowances.

Revenues and Expenditures

Some participants suggested that states need to show that matching funds come from state or local sources that otherwise could have gone to other programs in order to show that they are not recycled. Ideally, there should be a clear definition (in regulation) of what sources of state funds are allowable to be spent on Medicaid and then a separate process to track them. The regulation should be based on an analysis of how states characterize funds, how state budget processes work, and when a federal dollar, provided to a state in the form of a grant, loses its character as a federal dollar. Participants had different ideas about how to define appropriate state Medicaid expenditures. One view was that expenditures are appropriate when they represent claims paid for eligible people, covered services, and reimbursement is consistent with defined payment methodologies. Another view was that definitions of certified public expenditures must be commonly agreed upon and consistent across states.

Structure for Implementing New Rules

Clear federal rules should be developed in conjunction with states to guide states' fiscal practices. Formal rulemaking is preferable because it would give states notice of pending policy changes and an opportunity to comment before the agency's position is crystallized.

The Medicaid Architecture: Federal Statute, Regulations, Guidance, Waivers and State Plan Amendments

Like other federal entitlement programs, Medicaid is governed by statute, regulations, a program manual (with program transmittals which are used to communicate new or changed policies, and/or procedures that are incorporated into a specific CMS program manual),[1] "Dear State Medicaid Director" letters to clarify pressing issues, and additional communications between CMS regional offices and states. States also have their own Medicaid statutes, regulations, and policy manuals that reflect their programs, and include information about fiscal practices.[2]

Federal Statute

The current Medicaid statute provides broad language about CMS's authority to deal with fiscal integrity. The statute says that a state plan must "provide such methods and procedures relating to the utilization of, and the payment for, care and services available under the plan... as may be necessary to safeguard against unnecessary utilization of such care and services and to assure that payments are consistent with efficiency, economy, and quality of care."[3] CMS cites this statutory provision on "efficiency, economy and quality of care" as giving it broad discretion to stop states from using certain financing arrangements. In addition, the statute requires state Medicaid agencies to make reports, in such form and containing such information as the Secretary of HHS may from time to time require, and comply with such provisions as the Secretary may from time to time find necessary to assure the correctness and verification of such reports.[4] Since the 1980s, Congress has passed at least 11 distinct amendments to the Medicaid statute which attempt to address fiscal integrity problems, [see Appendix I in the full report], but no comprehensive statutory reform has been attempted.

Federal Rulemaking

Participants noted that the Medicaid regulations on the topic of fiscal integrity have generally tackled only one particular fiscal integrity issue at a time and some more completely than others. Participants generally recommended that Congress, the Administration, and states work to define fundamental concepts like "public expenditure," "allowable expenditure," "state matching dollar," and "state general revenue" in regulation. Many participants agreed that states could begin this process by giving the basic parameters to Congress and the Administration so they can debate the issues, consider whether legislation is needed, and then issue proposed rules, definitions, examples, and approaches on fiscal integrity.

Dear State Medicaid Director Letters

Dear State Medicaid Director (DSMD) letters, which could be a mechanism to clarify gray areas and share information with all states, generally have not been used to create clear policy on fiscal topics. CMS's use of these letters in general, and to deal with reimbursement/fiscal integrity issues in particular, has ebbed and flowed throughout the years. The number issued since 2000 has been far below that of the previous five-year period. Only 90 have been issued from 2001 to 2005, compared to 218 between 1996 and 2000.

Some participants suggested looking to the IRS as a model for the process of interpreting policy on state-federal issues. The IRS publishes the *IRS Bulletin*, which is a cumulative bulletin of its revenue rulings.[5] These rulings are legal opinions that apply across the board to all taxpayers who fit the circumstances. In the case of CMS, rulings could consist of agency opinion about fiscal integrity issues that would apply across the board to all the states that fit the circumstances. CMS could create a similar type of bulletin that would be available on its web site to states and other stakeholders.

Other Means – State Plan Amendments and Waivers

Many participants share a concern that CMS has used unusual means – divorced from the typical administrative process – to handle fiscal integrity issues. For example, in 2003, CMS began requiring "Five Funding Questions" (described further in the full report) to be answered before State Plan Amendments are approved. Although this document does not fit within the Administrative Procedures Act process, it may actually be one of the most comprehensive efforts to date to address fiscal

integrity. Since this requirement was put into practice, at least 25 states had agreed to sunset financing arrangements that do not satisfy the federal criteria. Many participants were also concerned that CMS has negotiated fiscal integrity issues on a state-by-state basis, rather than relying on consistent regulations or guidance. Participants generally agreed that the process of resolving fiscal integrity disputes should be separate and apart from waiver negotiations and approval of state plan amendments.

Federal Monitoring to Ensure Compliance with the Rules

It appears that current reporting mechanisms do not collect information that is sufficient to ensure fiscal integrity. Currently, the only financial information that CMS regularly collects from all states in a standardized manner is projected and actual expenditures, submitted on CMS-37 and CMS-64 forms. This information is required by law, and the data are used by CMS to determine and reconcile Federal matching payment to the states.

Certification Statements and Auditing

A new system that fosters fiscal integrity needs to contain strong certification statements, clear penalties for misreporting, and an independent auditing body to establish additional oversight. CMS could audit provider claims to examine whether provider payments are consistent with the payment methodology. One possibility is for CMS to collect data and approach reporting like a "Sarbanes-Oxley for States," requiring state submission of financial statements audited by an independent body, and certification of these statements, under penalty of perjury, by the State Medicaid Director or governor.[6]

Transparency

It might also be easier to monitor state activities if state Medicaid agencies made their policies and practices, and underlying documentation, more transparent. States should be given time to create web-based "annotated state plans." For example, each plan would have three columns, in the left-hand column there would be a reference to federal law or regulation, in the middle column there would be the state plan provision, and on the right, there would be live hyperlinks to state regulations, state manuals, or state contracts that implement those provisions. This way, how states comply with federal law becomes transparent, and can be updated in real-time, like a bulletin board that provides information to the federal government and the public.

Accountability Mechanisms

A new system of fiscal integrity would need to contain both incentives and consequences to ensure that states and the federal government all play by the rules. Independent review also might be needed.

- **Sticks for States** – The federal government could penalize states by creating a disallowance for inappropriate claims or unapproved funding mechanisms *and* requiring states to replace withdrawn federal money with state money, so that funds remain the same and program functions are not hurt.

- **Carrots for States** – The federal government could also reward states that follow the fiscal integrity rules by providing additional funding. The award could be based on a state's compliance record on fiscal integrity, as measured by an independent auditor.

- **Sticks for the Federal Government** – To hold the federal government accountable, CMS could be required to report annually to Congress on fiscal integrity efforts. Also, the HHS Inspector General could provide an annual review to ensure that CMS had not disallowed a state's practices unless they violated federal law or regulations. Last, the federal government could be required to reimburse states for any inappropriate disallowances.

Carrots for the Federal Government – There are inherent benefits to the federal government in creating and adhering to fiscal integrity policy. Also, the federal government will save time and energy currently spent trying to address fiscal integrity problems on a state-by-state basis.

HOW TO EVALUATE THE IMPACT AND SUCCESS OF FISCAL INTEGRITY MECHANISMS

Financial

There are a number of measures of improved fiscal integrity: a reduction in anomalies in spending trends over time; if nominal and net payments for individual providers – rather than a class of providers – were the same; and fewer or no retrospective denials of funding.

Cost of Compliance

Many participants were sensitive to a range of concerns about complying with new fiscal integrity rules. A major concern is that new fiscal integrity rules could cause states to lose federal funding that they currently rely on to enroll needy beneficiaries and pay providers for services. One suggestion was that changes be made on a prospective basis, with existing arrangements grandfathered-in or slowly phased out, to limit the destabilizing effect on states. Participants also expressed concern about the potential for additional time and administrative costs associated with complying with new fiscal integrity requirements. Making systems simple and coordinated or built on systems already in place would greatly help states. Perhaps the gravest concern among participants was that changes to fiscal integrity rules might reduce the availability of federal funds that states have come to rely on, which could harm states' program features and outcomes. These effects could include: provider rate reductions that reduce participation; cuts in eligibility that increase the number of uninsured residents; and cuts in benefits that lead to vulnerable patients going without needed care. Finally, many participants felt the nation needs to address the legitimate reasons why states engage in aggressive financing practices. States have used creative financing mechanisms to generate the revenue necessary to expand coverage to needy populations. A federal matching formula that quickly responds to economic downturns would reduce financial pressure on the program. Federal action to meet the needs of the growing number of people without health insurance also would reduce the burden on Medicaid programs to fill in this gap.

CONCLUSION

While concerns regarding Medicaid's fiscal integrity are warranted, they also need to be kept in perspective. The program is large and costly primarily because it serves more than 55 million people. Skirmishes over the balance between state and federal financing distract us from the greater challenge of operating the program efficiently, identifying sufficient funding, and considering options for reducing the number of Americans without health insurance.

While the meeting NASHP held regarding fiscal integrity was not designed to develop consensus, the clear sense among attendees was that the Medicaid program could do better. Many options exist for improving the intergovernmental financial relationship that underlies the program. The key features of a program with fiscal integrity are a clear set of rules, established through a public process, administered fairly and openly for all to see. A variety of possible mechanisms for setting those rules exists, but first, they must be developed and followed.

Improving Medicaid's fiscal integrity is at least as much of a political challenge as it is a substantive challenge. But it is a challenge worth taking on – because taxpayers deserve the best from the programs they fund – but also because political and administrative energy should be focused where it is needed most, which is on operating this complex and important program.

Notes

[1] Program transmittals used to be called program memos.
[2] The National Health Law Program and the National Association of Community Health Centers have published a state-by-state guide to institutional procedures to State Plan Amendments and Waivers. See, "Role of State Law in Limiting Medicaid Changes," April 2006, available at www.healthlaw.org.
[3] 42 U.S.C. S. 1396(a)(30)(A).
[4] 42 U.S.C. S. 1396(a)(6).
[5] Conversation with Stanley Oshinsky, Esq., Supervisory Attorney, Office of Director of Practice, IRS, November 21, 2005.
[6] Currently, states must certify that claimed expenditures are consistent with federal regulations and the state's approved Medicaid plan. GAO, "Medicaid Financing: States Use of Contingency Fee Consultants to Maximize Federal Reimbursements Highlight Need for Improved Federal Oversight," June 2005, p.2. GAO-05-748. However, an independent audit is not required.

About NASHP

The National Academy for State Health Policy is an independent academy of state health policymakers working together to identify emerging issues, develop policy solutions, and improve state health policy and practice. NASHP provides a forum for constructive, nonpartisan work across branches and agencies of state government on critical health policy issues facing states. We are a non-profit, non-partisan organization dedicated to helping states achieve excellence in health policy and practice.

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