DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

Memorandum

Date FEB 20 2001

From Michael F. Mangano
Acting Inspector General

Subject Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a Missouri Medicare Managed Care Risk Plan (A-07-00-00107)

To Michael McMullan
Acting Principal Deputy Administrator
Health Care Financing Administration

Attached are two copies of our final report entitled, "Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a Missouri Medicare Managed Care Risk Plan." The report is one in a series of reports that is part of our overall review of the administrative cost component of the adjusted community rate (ACR). The objective of the review was to examine the administrative cost component of the Contract Year 2000 ACR submitted by a Missouri managed care risk contractor (the Plan), and assess whether the costs were appropriate when considered in light of the Medicare program's general principle of paying only reasonable costs.

In an Office of Inspector General (OIG) audit report issued in January 2000,[1] we identified $66.3 million of administrative costs that were included in the adjusted community rate proposals (ACRP) submitted by nine managed care organizations (MCO) that would have been unallowable had the MCOs been required to follow Medicare's general principle of paying only reasonable costs. We recommended that the Health Care Financing Administration (HCFA) pursue legislation concerning MCOs' administrative costs which would require risk-based MCOs to follow Medicare's general principle of paying only reasonable costs. In response to our draft report, HCFA did not concur with the recommendation. The HCFA noted that it had recently revised the ACR methodology and that the new procedures will be reviewed to ensure the effectiveness of reducing the administrative burdens on the MCO.

However, based on the results of our audits at the nine MCOs, HCFA requested that OIG examine other MCOs to determine if administrative costs, that would be deemed unallowable under Medicare's reasonable cost principles, were included in the computation of the ACRPs under the revised format. This review is in response to HCFA's request.

[1]Review of the Administrative Cost Component of the Adjusted Community Rate Proposal at Nine Medicare Managed Care Organizations for the 1997 Contract Year (A-03-98-00046)

Presently, there is no statutory or regulatory authority governing allowability of costs in the ACR process, unlike other areas of the Medicare program. For example, regulations covering MCOs that contract with HCFA on a cost reimbursement basis provide specific parameters delineating allowable administrative costs for enrollment and marketing. These same guidelines, however, are not used in administering the MCO risk contracts.

Based on our audit, $783,297 in costs ($227,156 Medicare share) could have been eliminated when computing the ACR for this Missouri MCO, if Federal Acquisition Regulations Contract Cost Principles were applied to risk-based MCOs. These costs included donations, gifts, political contributions, lobbying, memberships, sponsorships, entertainment, parties, promotional giveaways, and out-of-period costs. In addition, plan officials did not provide documentation to support expenses in the amount of $2,243,313 ($650,561 Medicare share).

The effect of including these costs in the Plan's ACR proposal was to increase administrative costs for CY 2000. Using the resultant $7.63 per member per month rate reduction computed by eliminating these costs from the ACR proposal, we estimate that for CY 2000 beneficiaries paid about $1.5 million (based on the plan's projected Medicare enrollment levels) in excessive premiums and copayments.

In responding to our draft report, the Plan stated that it supports Medicare's general principle of paying only reasonable costs and agreed that Medicare payments to MCOs should be based on prudent and cost-conscious management concepts. However, Plan officials took issue with several items in the report. The Plan did not agree with our position on undocumented costs and took exception to our characterization of promotional giveaway costs as unreasonable, stating that marketing guidelines allow for the distribution of nominal gifts and promotional giveaways up to $10. The Plan also disagreed with our characterization of memberships, stating that memberships in professional organizations is often the most efficient means to assess necessary continuing education requirements for their employees.

Because of a lack of criteria for inclusion of administrative costs on the ACR proposal, there are no recommendations addressed to the Plan. While this review examined only one plan, we believe that our results of this Plan, and others previously issued, highlight a significant problem - administrative costs deemed unallowable under Medicare's reasonable cost principles are being paid with Medicare funds. It appears that this problem may be systemic and that it extends beyond the nine plans previously reviewed. We are continuing our reviews at other MCOs. The results of these reviews will be shared with HCFA in the coming months so that appropriate legislative changes can be considered. We invite HCFA's comments on our review as it proceeds.

Please advise us within 60 days on actions taken or planned on our recommendations. If you have any questions, please contact me or have your staff contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 786-7104.

To facilitate identification, please refer to Common Identification Number A-07-00-00107 in all correspondence relating to this report.

Attachments

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF ADMINISTRATIVE COSTS INCLUDED IN THE ADJUSTED COMMUNITY RATE PROPOSAL FOR A MISSOURI MEDICARE MANAGED CARE RISK PLAN

FEBRUARY 2001
A-07-00-00107

DEPARTMENT OF HEALTH & HUMAN SERVICES Office of Inspector General

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From Michael F. Mangano
Acting Inspector General

Subject Review of Administrative Costs Included in the Adjusted Community Rate Proposal for a Missouri Medicare Managed Care Risk Plan (A-07-00-00107)

To Michael McMullan
Acting Principal Deputy Administrator
Health Care Financing Administration

This final report presents the results of our review of the administrative costs included in the adjusted community rate proposal (ACRP) submitted to the Health Care Financing Administration (HCFA) for the 2000 Medicare contract year by a Missouri managed care risk contractor (the Plan). The objective of our review was to examine the Plan's administrative cost component of the ACRP, and assess whether the costs were appropriate when considered in light of the Medicare program's general principle of paying only reasonable costs.

In an Office of Inspector General (OIG) audit report issued in January 2000,[1] we identified \$66.3 million of administrative costs that were included in the ACRPs submitted by nine managed care organizations (MCO) that would have been unallowable had the MCOs been required to follow Medicare's general principle of paying only reasonable costs. We recommended that HCFA pursue legislation concerning MCOs' administrative costs which would require risk-based MCOs to follow Medicare's general principle of paying only reasonable costs. In response to our draft report, HCFA did not concur with the recommendation. The HCFA noted that it had recently revised the adjusted community rate (ACR) methodology and that the new procedures will be reviewed to ensure the effectiveness of reducing the administrative burdens on the MCO.

However, based on the results of our audits at the nine MCOs, HCFA requested that OIG examine other MCOs to determine if administrative costs, that would be deemed unallowable under Medicare's reasonable cost principles, were included in the computation of the ACRPs under the revised format. This review is in response to HCFA's request.

[1]Review of the Administrative Cost Component of the Adjusted Community Rate Proposal at Nine Medicare Managed Care Organizations for the 1997 Contract Year (A-03-98-00046)

The Medicare ACR process is designed for MCOs to present to HCFA their estimate of the funds needed to cover the costs of providing the Medicare package of services to any enrolled Medicare beneficiary. The MCO's anticipated or budgeted funds are calculated to cover direct medical care, administration, and the additional revenues (e.g., profits) of the Plan for the upcoming year and must be supported by the individual MCO's operating experiences related to utilization and expenses. All assumptions, cost data, revenue requirements, and other elements used by the MCO in the ACR proposal calculations must be consistent with the calculations used for the premiums charged to non-Medicare enrollees. The ACR proposal is integral to pricing an MCO's benefit package, computing "excess" amounts (if any) from Medicare payments, and determining additional benefits or reduced premiums that could be charged to Medicare beneficiaries.

Presently, there is no statutory or regulatory authority governing allowability of costs in the ACR process, unlike other areas of the Medicare program. For example, regulations covering MCOs that contract with HCFA on a cost reimbursement basis provide specific parameters delineating allowable administrative costs for enrollment and marketing. These same guidelines, however, are not used in administering the MCO risk contracts.

Based on our audit, $783,297 in costs ($227,156 Medicare share) could have been eliminated when computing the ACR for this Missouri MCO, if Federal Acquisition Regulations (FAR) Contract Cost Principles were applied to risk-based MCOs. These costs included donations, gifts, political contributions, lobbying, memberships, sponsorships, entertainment, parties, promotional giveaways, and out-of-period costs. In addition, plan officials did not provide documentation to support expenses in the amount of $2,243,313 ($650,561 Medicare share). The effect of including these costs in the Plan's ACR proposal was to increase administrative costs for Contract Year (CY) 2000. Using the resultant $7.63 per member per month (PMPM) rate reduction computed by eliminating these costs from the ACR proposal, we estimate that for CY 2000 beneficiaries paid about $1.5 million (based on the plan's projected Medicare enrollment levels) in excessive premiums and copayments.

Because of a lack of criteria for inclusion of administrative costs on the ACR proposal, there are no recommendations addressed to the Plan. This audit is part of a nationwide review of the ACR process and is being performed at other MCOs. Based on the results of the individual reviews, we will be making recommendations to HCFA.

INTRODUCTION

BACKGROUND

Medicare payments to risk-based MCOs are based on a prepaid capitation rate. The rate reflects the estimated costs that would have been incurred by Medicare on behalf of enrollees of the MCO if they received their covered services under Medicare fee-for-service. Risk contractors are required by section 1854 of the Social Security Act to compute an ACR proposal and submit it to HCFA prior to the beginning of the MCO's contract period. The HCFA encourages the providers to support their ACR proposal with the most current data available. The Medicare ACR process is designed for MCOs to present to HCFA their estimate of the funds needed to cover the medical and administrative costs of providing a Medicare package of services to a Medicare beneficiary.

To compute the ACR, an MCO calculates an initial rate that represents the average commercial (non-Medicare) premium that the MCO would charge its general non-Medicare-eligible population for the basic benefits and any mandatory supplemental benefits covered under the Medicare+Choice (M+C) plan. The rate is comprised of direct medical care, administration, and additional revenues or profit. The MCO should also calculate a separate initial rate (using the same approach) for each optional supplemental benefit offered in conjunction with an M+C plan. These initial rates are then modified by a factor that represents the difference in utilization characteristics between Medicare and non-Medicare enrollees. If the average Medicare payment rate is greater than the ACR, an excess amount is noted. The MCO is required to use the "excess" to either improve the Medicare enrollee benefit package, reduce the Medicare enrollee's premium, accept a reduced capitation payment, or contribute to a benefit stabilization fund.

The MCO manual requires all assumptions, cost data, revenue requirements, and other elements used by the MCOs in their ACR proposal calculations be consistent with the calculations used to compute premiums charged to non-Medicare enrollees. The MCO cost data is especially important due to changes brought about by the Balanced Budget Act of 1997 (Public Law 105-33). For CY 2000, administrative costs are determined using a relative value cost ratio based on actual administrative costs incurred for Medicare beneficiaries in a base year (prior year) to actual administrative costs incurred for non-Medicare enrollees in the same base year. However, the HCFA guidelines do not require that MCOs adhere to cost principles that preclude the reporting of unreasonable, unnecessary, and/or unallocable administrative costs.

SCOPE

The objective of the review was to examine the administrative cost component of the 2000 ACR proposal submitted by the Missouri plan, and assess whether the costs were appropriate under Medicare's general principle of reasonableness. To accomplish our objective we:

- reviewed the applicable laws and regulations;
- discussed with the Missouri plan officials their ACR proposal process and the calculation of administrative costs in the 2000 ACR proposal;
- reviewed the National Data Reporting Requirements (NDRR) reports; and
- selected categories of administrative costs from the Missouri plan's 1998 general ledger. The selected cost categories have historically been problematic areas in the Medicare fee-for-service program.

From total administrative costs of $39,008,701 reflected in the Plan's Fiscal Year 1998 financial statements, we judgmentally selected 22 administrative cost accounts totaling $8,580,990 for review. We then reviewed each of these accounts using the guidelines HCFA applies to cost-based MCOs and Medicare fee-for-service carriers, intermediaries, and providers, since HCFA guidance does not specify which administrative costs may be included in an ACR proposal.

The review was performed in accordance with generally accepted government auditing standards. The objective of the review did not require us to review the internal control structure of the Missouri plan. Because we reviewed a judgmental sample, our findings cannot be projected to the universe of administrative costs submitted by the Missouri plan. The Missouri plan's records did not separate its actual Medicare costs from its total costs. Based on the allocation method used by the plan, we were able to distinguish these costs with a certain level of reliability. Field work was performed at the Missouri plan's offices.

FINDINGS AND RECOMMENDATIONS

Of the $8,580,990 in administrative costs selected for review, we identified costs of $783,297 ($227,156 Medicare share) recorded on the Plan's books which were not appropriate when compared to the Medicare program's general principle of paying only reasonable costs and $2,243,313 ($650,561 Medicare share) in costs for which the Plan could not provide supporting documentation. We reviewed each of the selected costs using the guidelines HCFA applies to cost-based MCOs and Medicare fee-for-service carriers, intermediaries, and providers. If existing Medicare regulations were applied to risk-based MCOs, we believe the following costs recorded in the Plan's books would not be allowable:

COSTS THAT WOULD BE INAPPROPRIATE UNDER FARs

- Promotional Giveaways - $207,672: Charges included $165,672 for promotional giveaway items such as clothing and novelties containing the plan logo, and $42,000 for birthday gifts for current Medicare plan members.

- Entertainment/Parties - $196,794: Entertainment amounts included $53,999 for country club dues, golf tournaments, and golf outings; $7,158 for tickets to college and professional sporting events; and, $16,172 for guest speakers for insurance broker's breakfasts. Parties included such items as $41,306 for meals for staff meetings and sales luncheons; $30,445 for a Christmas party; and $9,902 for sports-related luncheons and tail-gate parties.

- Donations/Gifts - $120,534: Donations represented contributions and other payments to charitable and other organizations such as United Way; March of Dimes; and a local parochial school, museum, and zoo. Gift recipients included employees, board members, insurance brokers, and various committee members. Gift items included such items as flowers, holiday gift baskets, gift certificates, and massages.

- Out-of-Period Costs - $118,106: These costs represented costs that were recorded on the ledger accounts for 1998, but should have been recorded in the years they were incurred - 1997 and 1999.

- Memberships/Sponsorships - $46,962: Costs included memberships in a number of local chambers of commerce, clubs, and other organizations. Sponsorships included entry fees for an amateur sporting event, dinner patron for a local organization, and sponsorship of a local women's foundation.

- Political Contributions/Lobbying - $32,738: Political contributions were made to a variety of State and local political campaigns including the offices of governor, representative, senate, and county legislator. Lobbying costs were primarily for the services of a professional lobbyist.

- Miscellaneous Other - $60,491: Other costs included bad debts expense for an employee loan, organization costs, and fines.

UNSUPPORTED COSTS

The Plan could not provide supporting documentation for $2,243,313 ($650,561 Medicare share) in administrative costs. These costs included:

- rent expense - $1,426,430,
- consulting expense - $328,676,
- purchased services -$317,150,
- public relations - $52,283,
- legal expense - $40,000,
- loss on disposals - $36,268, and
- miscellaneous other accounts -$42,506.

The Plan cited a number of reasons for their inability to provide the supporting documentation in a timely manner, including difficulty finding the records which were stored in boxes, concurrent reviews by State auditors, and the recent loss of experienced personnel. Therefore, the reasonableness of these costs could not be established.

The effect of including these costs in the Plan's ACR proposal increased administrative costs for CY 2000. Using the resultant $7.63 PMPM rate reduction computed by eliminating these costs from the ACR proposal, we applied this reduction rate to the projected Medicare member months of 200,688 resulting in a total reduction of $1,531,250. Consequently, we believe that for CY 2000, beneficiaries may have incurred $1,531,250 in excessive premiums and copayments.

CONCLUSIONS

Our review showed that certain costs included in the Plan's administrative cost component of the ACR proposal were inconsistent with the Medicare program's general principle of paying only reasonable costs. While we recognize that, unlike other areas of the Medicare program, there is currently no statutory or regulatory authority governing the allowability of administrative costs in the ACR process, we question the equity of including costs in the ACR process that are unallowable in other facets of the Medicare program.

RECOMMENDATIONS

We believe the use of Medicare trust funds to pay monthly MCO capitation payments should not exceed an amount that would be allowed using existing regulations applied in other areas of the Medicare program that include prudent and cost-conscious management concepts. Despite the lack of specific guidelines for MCO risk contracts, we believe that those costs that would not be allowable under other areas of the Medicare program should be eliminated from the Medicare ACR calculation.

However, because the elimination of such administrative costs from the ACR computation is not currently a requirement applicable to risk-based MCOs, we have made no recommendations to the Missouri plan. Instead, the results of this review along with similar reviews at other MCOs will be shared with HCFA so that appropriate legislative changes can be considered.

The Missouri Plan MCO's Comments

The Plan supported Medicare's general principle of paying only reasonable costs and agreed that Medicare payments to MCOs should be based on prudent and cost-conscious management concepts. The Plan stated that because there is currently no regulatory or statutory guidance related to allowable administrative costs, they were pleased to have participated in the review, with the goal of developing such guidance.

The Plan's officials took issue with several areas of the report. Officials at the Plan were greatly concerned that the audit report remain confidential, and that the Plan's identity not be disclosed. In this regard, the Plan felt the specific description of a marketing technique under "Promotional Giveaways" would easily identify their organization.

The Plan did not agree with our position on undocumented costs, stating that they strive to maintain thorough and accurate documentation of all costs, and felt that all requested documentation had been provided. If that was not the case, however, they were willing to respond to any requests for specifically identified items.

The Plan took exception to our characterization of promotional giveaway costs ($207,672) as unreasonable, stating that marketing guidelines allow for the distribution of nominal gifts and promotional giveaways up to $10. The Plan also disagreed with our characterization of memberships ($46,962), stating that memberships in professional organizations is often the most efficient means to assess necessary continuing education requirements for their employees.

The full text of the Plan's comments has been included as an Attachment to this report.

OIG's Response

In accordance with the Plan's wishes for anonymity, we have revised the report to exclude specific references to certain marketing practices, and have excluded names and addresses from the Plan's response to this report.

We disagree with the Plan's statements regarding undocumented costs. Within the first few days of our review, we requested Plan officials provide supporting documentation for a sample of general ledger account entries. During approximately four weeks of field work, we repeatedly provided Plan officials with lists of items not yet received. Twice, work was halted as we left the site to allow the Plan more time to gather documents for us. We believe the Plan was afforded ample opportunity to support the subject costs.

Regarding promotional giveaways, we concede that HCFA marketing guidelines permit gifts of nominal value (limited to $10 per event per beneficiary) under certain conditions and with certain restrictions. However, we believe if the Plan had not spent $207,672 on promotional giveaways, it could have provided extra additional benefits in this amount to Medicare beneficiaries.

We disagree with the Plan's comments that costs incurred for sponsoring a sporting event and a woman's foundation qualify as continuing education needs.

September 8, 2000

Barbara A. Bennett
Regional Inspector General for Audit Services
Department of Health & Human Services
Offices of Inspector General
Office of Audit Services
Region VII
601 E. 12th Street, Room 284A
Kansas City, MO 64108

RE: Response to Draft Audit Report – Review of Administrative Costs Included in the 2000 ACRP

Dear Ms. Bennett:

We are in receipt of your letter dated August 16, 2000 requesting our comments relating to the draft audit report on your review of administrative costs included in our 2000 ACRP. Thank you for the opportunity.

We strongly support Medicare's general principle of paying only reasonable costs. It is agreed that Medicare payments to M+COs should be based upon prudent and cost-conscious management concepts. Currently, there is no regulatory or statutory guidance related to allowable administrative costs for M+COs to follow during the ACR process. For this reason, we are pleased to have participated in your review of M+COs across the country with the goal of developing such guidance.

During your review, baseline (1998) administrative costs were scrutinized using new guidelines that were never published for M+COs. Had M+COs been governed by the Federal Acquisition Regulations Contract Cost Principles, we would have made every attempt to comply by using a pure cost accounting methodology to arrive at the input administrative costs for the ACRP.

The methodology that was used to arrive at the baseline administrative costs was based upon percentage allocations to various product lines. It assigns a certain percentage of total administrative costs to conducting business as a M+CO. So while some charges are incurred with no ties to the Medicare program, such as speaker fees for an insurance brokers event, other charges can be designated at varying percentages and even at 100%, such as salaries for Medicare sales and customer service representatives. Taken in aggregate, X% of the administrative costs is related to the Medicare program. We have chosen to allocate X% of every charge to the Medicare program versus varying the percentage of each charge to arrive at the aggregate X%. The baseline administrative costs used to calculate the ACR does not vary significantly.

This allocation methodology is also used to determine premium charged to non-Medicare enrollees. This conforms to the existing requirement that all assumptions, cost data, revenue requirements and other elements used in the ACRP be consistent with the calculations used to compute premiums charged to non-Medicare enrollees.

The draft report concludes that certain costs are unallowable only because "the Plan could not provide supporting documentation." While it was, in certain instances, more time-consuming to obtain the supporting documentation due to reasons cited in the draft audit report, we feel that all requested documentation was provided to the auditors. We strive to maintain thorough and accurate documentation of all costs. If for some reason, the auditors did not receive requested documentation, please specifically identify them and we would be more than willing to respond accordingly. Given that the entire amount of "undocumented costs" is significant and deemed in the report as unallowable, we feel strongly that the draft audit report conclusions are incomplete.

Current M+CO marketing guidelines allows for distribution of nominal gifts and promotional giveaways up to $10. The audit report suggests that the cost of these items are in violation of what the OIG would propose as allowable costs. HCFA will need to reconcile these types of conflicting guidelines. Another example of conflicting guidelines deals with memberships in professional organizations. These organizations are often the most efficient means to access necessary continuing education requirements in order for our RNs, MDs, sales representatives, legal staff, and accounting staff to maintain their licenses.

We are of the understanding that the audit report will remain confidential and that our identity will not be disclosed. As we discussed over the telephone, the specific description of the marketing technique under "Promotional Giveaways" easily identifies our organization in this geographic market. This letter confirms that the OIG has agreed to consider deleting the specific description from the audit report. Thank you.

Finally, we understand the need for HCFA to propose reasonable allowable cost guidelines for M+COs to assist both parties in meeting their obligations to Medicare beneficiaries. We trust that this audit report is given to HCFA with that sole purpose in mind and would support that recommendation. It would be unfortunate to tarnish the reputation of our organization if the audit report were made public, regardless of whether this was released intentionally or not. We are not in violation of current ACR guidelines, strongly disagree with the specific review findings as stated above, and ultimately support the OIG's recommendations to HCFA as outlined in the draft audit report.

Again, we thank you for the opportunity to review and comment on the draft audit report. It is our hope that the OIG will consider them for inclusion when the report is issued to HCFA.

Sincerely,