



DEPARTMENT OF HEALTH AND HUMAN SERVICES

## OFFICE OF INSPECTOR GENERAL

WASHINGTON, DC 20201



April 27, 2015

**TO:** Andrew M. Slavitt  
Acting Administrator  
Centers for Medicare & Medicaid Services

**FROM:** /Daniel R. Levinson/  
Inspector General

**SUBJECT:** Early Alert: Without Clearer Guidance, Marketplaces Might Use Federal Funding Assistance for Operational Costs When Prohibited by Law (A-01-14-02509)

The purpose of this memorandum is to alert you to a potential issue identified during our audits of establishment grants received by State-based marketplaces (SBMs). Our objective was to determine whether certain SBMs complied with Federal requirements related to the development and implementation of a marketplace in accordance with the terms and conditions of Federal awards for the audit period from August 2011 through September 2014. Starting in January 2015, establishment grant funds provided by the Centers for Medicare & Medicaid Services (CMS) to the SBMs cannot be used for operational costs. We have concerns that, without more detailed guidance from CMS, SBMs might have used, and might continue to use, establishment grant funds for operating expenses after January 1, 2015, contrary to law. This issue is a significant matter and requires CMS's immediate attention.

### BACKGROUND

The Affordable Care Act (ACA) established a competitive private health insurance marketplace through health insurance exchanges (commonly referred to as "marketplaces") in all 50 States and the District of Columbia (States). CMS's Center for Consumer Information and Insurance Oversight oversees the implementation of the ACA provisions related to health insurance and works with States to establish marketplaces.

Section 1311 of the ACA provides funding assistance to the States for the planning and establishment of marketplaces<sup>1</sup> and provides that no grant shall be awarded after January 1,

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<sup>1</sup> For purposes of this early alert, the term "establishment grants" includes all funding made available to States under the ACA § 1311(a). CMS provided several different funding opportunities available to States, including early innovator cooperative agreements, planning and establishment grants, and establishment cooperative agreements. For more information on the specific types of funding assistance, see Attachment A.

2015, for the States to establish marketplaces. It further instructs that a marketplace must be self-sustaining by January 1, 2015, and allows marketplaces to charge assessments or user fees to participating health insurance issuers or to generate funding otherwise “to support its operations.” To implement these provisions, CMS has provided guidance stating that after January 1, 2015, these Federal funds may not be used to cover maintenance and operating costs, which include rent, software maintenance, telecommunications, utilities, and base operational personnel and contractors.<sup>2</sup>

CMS allows establishment grant funds to be used for activities that do not relate to the operational costs of the marketplaces after January 1, 2015. Specifically, through No Cost Extensions (NCEs), CMS has extended the project period beyond December 31, 2014, for some existing establishment grants that it awarded to SBMs between August 2011 and December 2014. These NCEs allow SBMs to complete the design, development, and implementation activities of a marketplace but do not authorize the SBMs to use these funds for operational purposes. In addition, during December 2014, the last month in which CMS could issue establishment grant funding assistance under the ACA, section 1311, CMS awarded approximately \$420 million in additional funding for the design, development, and implementation of SBMs and State partnership marketplaces.<sup>3</sup>

## **SUMMARY OF ISSUE**

We have concerns that, without more detailed guidance from CMS, SBMs might have used, and might continue to use, establishment grant funds for operating expenses after January 1, 2015, contrary to law. In media reports and during our review of SBMs’ budget information, we have observed that some SBMs face uncertain operating revenues in 2015 and future years. Because operating revenues are uncertain, there is a risk that SBMs might use establishment grant funds to cover operational costs.<sup>4</sup>

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<sup>2</sup> CMS, *FAQs on the Use of 1311 Funds and No Cost Extensions* (Mar. 14, 2014).

<sup>3</sup> A State may establish a State partnership marketplace, in which the Department of Health and Human Services (HHS) and the State share responsibilities for core functions. For example, HHS may perform certain functions, such as eligibility determinations, and the State may perform other functions, such as insurance plan management and consumer outreach.

<sup>4</sup> For example, two SBMs, Rhode Island and Washington State, face uncertainties in operating revenue. Rhode Island’s HealthSourceRI (HSRI) currently does not have a dedicated revenue stream but is considering generating operating revenue in part by selling the tools and products that it develops to other States and advertising on HSRI’s Web site, according to a letter from the director of HSRI to Rhode Island’s Governor that accompanied HSRI’s budget submission for fiscal years 2015 and 2016. In its January 22, 2015, budget presentation to the Washington Health Benefit Exchange Board, the 11-member board that governs the Washington Health Benefit Exchange (WHBE), the WHBE forecasted \$26.1 million in revenues (20.6 percent of total revenues) from premium taxes and carrier fees for fiscal year 2015, based on 213,000 enrollees. As of February 15, 2015, only 160,000 people had enrolled (75 percent of projected enrollment). If a significant shortfall continues, it could affect WHBE’s ability to fund operations.

Current guidance that implements the statutory prohibitions describes only broad categories of costs that SBMs cannot cover using this funding assistance. For example, the current guidance states that the ACA, section 1311, funds made available for an extended period through an NCE cannot be used to cover maintenance and operating costs, such as rent, software maintenance, telecommunications, utilities, and base operational personnel and contractors, but does not provide specifics on other key costs, such as call centers and in-person assisters. Without specific guidance that clearly defines the difference between a design, development, and implementation expense (potentially allowable) and an operating expense (statutorily prohibited), there is a risk that SBMs might inappropriately use establishment grant funds for operational costs. For example, according to its budget documents WHBE might use \$10 million in establishment grant funds to support operations from July 1 to December 31, 2015. Budgeted operating costs include \$2 million for printing and postage and \$2 million for bank fees.<sup>5</sup> Additional guidance would help ensure that WHBE and other SBMs use establishment grant funds for allowable design, development, and implementation expenses only.

In addition, more specific guidance should make clear that the ACA, section 1311, applies to funds made available through NCEs and newly awarded grants. Specific examples of potentially allowable and statutorily prohibited costs would be useful. Additional guidance would help the SBMs by providing better clarity and certainty of the allowability of costs and would help ensure proper oversight of this funding limitation in the ACA.

## **CONCLUSION**

The ACA, section 1311, establishes a clear prohibition that marketplaces cannot use grant funds to support ongoing operations. After January 1, 2015, the funds can be used only for design, development, and implementation expenses. Outside of some broad categories set out in existing CMS guidance, “operating expense” and “design, development, and implementation expenses” have little meaningful distinction. Thus, we encourage CMS to consider developing and publishing clear guidance on what constitutes (1) operational costs and (2) design, development, and implementation costs to minimize the marketplaces’ improper use of establishment grant funding for operational expenses after January 1, 2015. We further encourage CMS, in developing this guidance, to review SBM plans for using establishment grant funds to ensure that the guidance addresses real-world examples, such as call centers, in-person assisters, bank fees, and printing and postage expenses. We also encourage CMS to monitor SBMs’ use or potential use of establishment grant funds for operational costs and take appropriate action.

If you have any comments or questions about this memorandum, please do not hesitate to call me, or your staff may contact Kay L. Daly, Assistant Inspector General for Audit Services, at (202) 619-1157 or through email at [Kay.Daly@oig.hhs.gov](mailto:Kay.Daly@oig.hhs.gov).

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<sup>5</sup> Budget information based on WHBE’s “Exchange Budget Update” presentation to the Washington Health Benefit Exchange Board on January 22, 2015.

## **ATTACHMENT A: TYPES OF FUNDING ASSISTANCE**

CMS provided three types of funding assistance: planning and establishment grants, early innovator grants, and Level One and Two establishment grants.

### **PLANNING AND ESTABLISHMENT GRANTS**

State planning and establishment grants were available to all the States for planning and establishing State marketplaces. States may use these funds in a variety of ways, including assessing current information technology systems; determining the statutory and administrative changes needed to build marketplaces; and coordinating streamlined eligibility and enrollment systems across State health programs, including Medicaid and the Children’s Health Insurance Program. Forty-nine States were awarded funding through the State planning and establishment grants of \$44 million.

### **EARLY INNOVATOR GRANTS**

The Cooperative Agreement To Support Innovative Exchange Information Technology Systems provided States with competitive incentives to design and implement the information technology infrastructure needed to operate marketplaces. Six States and a multi-State consortium were awarded funding through the early innovator grants of \$241 million.

### **LEVEL ONE AND TWO ESTABLISHMENT GRANTS**

The Cooperative Agreement To Support Establishment of State-Operated Health Insurance Exchanges provided States with financial assistance to establish marketplaces. States could initially apply for Level One or Level Two establishment cooperative agreements. Level One grantees could apply for another Level One cooperative agreement with a subsequent application deadline. Level One grantees could also apply for a Level Two cooperative agreement if they had made sufficient progress in the initial Level One project period and were able to satisfy the eligibility criteria for Level Two defined in section III.1 of the Funding Opportunity Announcement. Thirty-seven States were awarded funding through the Level One and Two establishment grants of \$4.8 billion.