



January 18, 2011

TO: Donald M. Berwick, M.D.
Administrator
Centers for Medicare & Medicaid Services

FROM: /Daniel R. Levinson/
Inspector General

SUBJECT: Rollup Review of Impact on Medicare Program for Investment Income That Medicare Advantage Organizations Earned and Retained From Medicare Funds in 2007 (A-07-10-01080)

The attached final report provides the results of our rollup review in which we estimated the financial impact on the Medicare program of investment income that Medicare Advantage organizations earned and retained from Medicare funds in 2007.

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If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact Robert A. Vito, Acting Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through email at Robert.Vito@oig.hhs.gov. We look forward to receiving your final management decision within 6 months. Please refer to report number A-07-10-01080 in all correspondence.

Attachment

Department of Health & Human Services

**OFFICE OF
INSPECTOR GENERAL**

**ROLLUP REVIEW OF IMPACT ON
MEDICARE PROGRAM FOR
INVESTMENT INCOME THAT
MEDICARE ADVANTAGE ORGANIZATIONS
EARNED AND RETAINED FROM
MEDICARE FUNDS IN 2007**



Daniel R. Levinson
Inspector General

January 2011
A-07-10-01080

Office of Inspector General

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EXECUTIVE SUMMARY

BACKGROUND

The Centers for Medicare & Medicaid Services (CMS) finances the Medicare program through the Federal Hospital Insurance (Part A) and Supplementary Medical Insurance (Part B) trust funds. The assets of the trust funds are held in special-issue U.S. Treasury securities, which earn interest income. The Medicare Part C program offers beneficiaries managed care options through the Medicare Advantage program (formerly called Medicare+Choice), which is also financed by the Part A and Part B trust funds.

Pursuant to the Social Security Act (section 1853(a)(1)(A), 42 U.S.C. § 1395w-23(a)(1)(A)), CMS makes advance capitated payments (prepayments) to Medicare Advantage organizations (MA organizations) for each enrollee at the beginning of each month. MA organizations may invest these Medicare funds in interest-bearing instruments until the funds are needed to pay for medical and administrative services. Federal law does not currently limit the ability of MA organizations to retain as additional revenue the investment income earned on Federal funds. MA organizations must submit, on an annual basis, bid proposals containing their anticipated revenue requirements for providing medical services under each of their plans for the upcoming year.

We issued an audit report (A-02-98-01005) to CMS on August 18, 2000, that identified more than \$100 million of investment income that MA organizations earned on Medicare funds of approximately \$20 billion for calendar year (CY) 1996. In that report, we noted that Federal requirements governing the Federal Employees Health Benefits (FEHB) program limited the ability of insurance companies participating in that program to generate and retain investment income. Because Federal requirements did not limit the ability of Medicare+Choice organizations to retain investment income, we recommended that CMS pursue legislation to address the timing of Medicare's prepayments to Medicare+Choice organizations or reduce the payment rates by the amount of investment income. In its comments on that report, CMS indicated that it did not intend to propose such legislation.

During CY 2007, CMS paid 457 MA organizations nationwide approximately \$69 billion in prepayments. As a followup to our previous audit, we performed audits at 50 MA organizations nationwide to estimate the investment income earned from Medicare funds received in CY 2007 and thereby estimate the investment income that the 457 MA organizations earned.

OBJECTIVE

Our objective was to estimate the financial impact on the Medicare program of limiting the ability of MA organizations to retain investment income earned on Medicare funds.

RESULTS OF REVIEW

Because Federal requirements governing the Medicare Advantage program do not limit the ability of MA organizations to retain investment income earned on Medicare funds, the Medicare

program loses potential cost savings. Based on our reviews of 50 MA organizations, the Medicare program continues to lose potential savings because in CY 2007 the 457 MA organizations held Medicare funds for approximately 46 days before paying for medical services. Specifically:

- If Federal requirements had been established to delay the prepayments to MA organizations until after the beginning of the beneficiary's coverage period (similar to the FEHB program) by the same 46 days that the MA organizations held Medicare funds, the Medicare Part A and Part B trust funds could have earned approximately \$450 million of interest income in CY 2007.
- Alternatively, if Federal requirements had been established to require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income, the Medicare program could have saved an estimated \$376 million that the 457 MA organizations earned in CY 2007.

In contrast to the Federal requirements that govern the Medicare Advantage program, the FEHB program limits the ability of companies to retain as additional revenue the investment income earned from Federal funds.

Neither of our legislative or regulatory recommendations from our previous audit report was implemented: that CMS either address the timing of its prepayments to MA organizations or reduce the payment rates by the amount of investment income that the MA organizations earned in CY 1996.

In this context, MA organizations and CMS officials have stated that if either of our previous legislative or regulatory recommendations were to be implemented, some MA organizations would increase their bid proposals to recoup investment income that they would lose. If the MA organizations were to increase their bid proposals to account for the proposed offsets, these higher costs would be recognized in the bid proposals and could result in a possible decrease in our estimated cost savings. However, this could provide greater transparency for program officials. It should be noted that section 1103 of the Health Care and Education Reconciliation Act of 2010, P. L. No. 111-152, has a provision to restrict the total amount of administrative costs reimbursed by CMS to MA organizations. Consequently, this provision may discourage MA organizations from increasing their future bid proposals to recoup investment income that they would lose.

We therefore encourage CMS to study these audit results, consider the impact of the investment income earned on Medicare funds, and review our conclusions and recommendations to improve the economy and efficiency of the Medicare Advantage program.

RECOMMENDATION

We recommend that CMS evaluate these audit results and either:

- pursue legislation to adjust the timing of Medicare’s prepayments to MA organizations to account for the time that these organizations invest Medicare funds before paying providers for medical services or
- develop and implement regulations that require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income.

CENTERS FOR MEDICARE & MEDICAID SERVICES COMMENTS

In written comments on our draft report, CMS did not concur with our recommendation because, in CMS’s judgment, the implementation of either option would cause most MA organizations to increase their bid proposals to recoup the investment income that they would lose, which would result in a decrease in most or all of the estimated cost savings. CMS also stated that implementing either option could create an undesirable precedent that could result in CMS making additional Parts C and D payments to MA organizations. CMS added that it assumes that it would be asked to pay interest on the additional payments that CMS frequently makes to MA organizations after the completion of the risk adjustment reconciliation each year and said that “[w]e believe a statutory change would be required to impose such an obligation on CMS”

CMS’s comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing CMS’s comments, we maintain that our findings and recommendation are valid. We agree with CMS’s statement that if MA organizations were to increase their bid proposals, our estimated cost savings would be reduced. However, we disagree with CMS’s assertion that implementing our recommendation would result in a decrease in most or all of the estimated cost savings. Specifically, the provisions from the Health Care and Education Reconciliation Act of 2010 that will modify the Medicare Advantage payment structure, as well as the effects of market competition, may discourage MA organizations from increasing future bid proposals. Further, any decrease in the estimated cost savings caused by increases in MA organizations’ bid proposals would be reduced because of the difference between the higher interest earned by the Medicare trust funds and the lower interest earned by MA organizations.

We agree that if CMS were required to pay interest on additional MA payments made after the risk adjustment reconciliation, the estimated savings we have identified would be reduced. However, it is not clear that Congress would enact legislation to require CMS to pay interest on these additional payments.

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A: SELECTION OF 50 MEDICARE ADVANTAGE ORGANIZATIONS AND ESTIMATION METHODOLOGIES

B: CENTERS FOR MEDICARE & MEDICAID SERVICES COMMENTS

INTRODUCTION

BACKGROUND

Medicare Advantage Program

The Centers for Medicare & Medicaid Services (CMS) finances the Medicare program through the Federal Hospital Insurance (Part A) and Supplementary Medical Insurance (Part B) trust funds. The assets of the Part A and Part B trust funds are held in special-issue U.S. Treasury securities, which earn interest income.

The Balanced Budget Act of 1997, P.L. No. 105-33, established Medicare Part C to offer beneficiaries managed care options through the Medicare+Choice program. Managed care organizations include health maintenance organizations, preferred provider organizations, provider-sponsored organizations, and private fee-for-service organizations. Section 201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 revised Medicare Part C. Among its changes, this law renamed the Medicare+Choice program the Medicare Advantage program. CMS finances the Medicare Advantage program from both the Part A and Part B trust funds.

Federal regulations (42 CFR § 422.254) state that each Medicare Advantage organization¹ (MA organization) that participates in the Medicare Advantage program must submit an annual bid proposal containing its anticipated revenue requirements for providing medical services under each of its plans for the upcoming year. The bid proposal categorizes anticipated revenue requirements as medical services, nonmedical services, and gain/loss margins.

Pursuant to CMS's bid proposal instructions, an MA organization is permitted, but not required, to offset the revenue that it needs to provide Medicare benefits to the average beneficiary by its anticipated investment income earned on CMS payments. CMS evaluates the bid proposals in determining the capitation payments (discussed below) that it will make to each MA organization.

Methodology for Centers for Medicare & Medicaid Services Prepayments to Medicare Advantage Organizations

Pursuant to the Social Security Act (section 1853(a)(1)(A), 42 U.S.C. § 1395w-23(a)(1)(A)), CMS makes advance capitated payments (prepayments) to MA organizations for each Medicare Advantage plan enrollee each month. CMS makes these prepayments at the beginning of the month based on the most current information available. If CMS receives demographic or health status information that would increase or decrease the previous monthly prepayments, it makes retroactive adjustments to correct the payment level.² Thus, each month CMS makes

¹ Federal regulations (42 CFR § 422.2(3)) define MA organization as “a public or private entity organized and licensed by a State as a risk-bearing entity ... that is certified by CMS as meeting the MA contract requirements.”

² CMS makes retroactive adjustments for changes in demographic status on a monthly basis and for changes in health status generally in August of each year.

prepayments to MA organizations and retroactive adjustments (both positive and negative) to correct previous prepayments to those organizations.

MA organizations must use these prepayments to arrange and pay for all medically necessary services that are allowable in the traditional Medicare fee-for-service program. MA organizations may invest these Medicare funds in interest-bearing instruments until the funds are needed to pay for medical and administrative services. Federal law does not currently limit the ability of MA organizations to retain as additional revenue the investment income earned on Federal funds.

During calendar year (CY) 2007, CMS paid 457 MA organizations approximately \$69 billion in prepayments, which was financed by the Part A and Part B trust funds.

Office of Inspector General Audits

In a report issued August 18, 2000,³ we identified more than \$100 million of investment income that Medicare+Choice organizations earned on payments of approximately \$20 billion in CY 1996. In that report, we noted that Federal requirements governing the Federal Employees Health Benefits (FEHB) program limited the ability of insurance companies participating in the program to generate and retain investment income. Because Federal requirements did not limit the ability of Medicare+Choice organizations to retain investment income, we recommended that CMS pursue legislation to address the timing of Medicare's prepayments to Medicare+Choice organizations or reduce the payment rates by the amount of investment income. In its comments on the report, CMS indicated that it did not intend to propose such legislation.

As a followup to our previous audit, we performed audits at 50 MA organizations nationwide to estimate the investment income earned from Medicare funds received in CY 2007 and thereby estimate the investment income that the 457 MA organizations earned.

Government Accountability Office Report Regarding Cash Management

In January 2009, the Government Accountability Office (GAO) issued a report⁴ concerning the financial impact of the differences between the time that the U.S. Department of the Treasury (Treasury) receives cash to fund a program and the time that it disburses cash to the program. GAO reported that payments made at the beginning of the month, including payments to MA organizations, contributed to misalignment of cash flows because Treasury did not receive much of its cash until midmonth. GAO recommended that Treasury and CMS "... expeditiously convene a joint interagency effort to study options identified by GAO and any other options that would improve Treasury's ability to manage cash flow and reduce overall interest costs while not unduly increasing administrative burden for CMS." Both Treasury and CMS agreed with GAO's recommendation.

³ *Results of the Audit of Investment Income Earned by Managed Care Organizations With Risk-Based Contracts* (A-02-98-01005).

⁴ GAO-09-118, *Debt Management: Treasury's Cash Management Challenges and Timing of Payments to Medicare Private Plans*, January 30, 2009.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to estimate the financial impact on the Medicare program of limiting the ability of MA organizations to retain investment income earned on Medicare funds.

Scope

We reviewed the approximately \$69 billion of prepayments made to 457 MA organizations during CY 2007. We identified 460 MA organizations that CMS categorized as health maintenance organizations, preferred provider organizations, provider-sponsored organizations, or private fee-for-service organizations. However, we did not review 3 of the 460 MA organizations at the request of the Office of Inspector General (OIG), Office of Investigations.

We did not review CMS's system of internal controls because our objective did not require us to do so.

Methodology

To accomplish our objective, we did the following:

- We reviewed Federal requirements to understand:
 - how CMS earns interest income from the assets held in the Medicare Part A and Part B trust funds and how CMS makes payments to MA organizations and
 - how companies participating in the FEHB program manage cash.
- We interviewed, in the performance of the 50 OIG audits, CMS and MA organization officials to gain an understanding of the treatment of investment income for the Medicare Advantage program.
- We reviewed the findings and recommendations of the GAO report regarding cash management.
- We accessed CMS's Web site to identify the MA organizations that participated in the Medicare Advantage program during CY 2007.
- We accessed CMS's Medicare Advantage and Prescription Drug system to identify the total prepayments that MA organizations received during CY 2007.
- From the *2008 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, we determined the effective annual rates of interest earned by the assets of the Part A and Part B trust funds for CY 2007.

- We analyzed the results of our 50 OIG audits of MA organizations to make estimates regarding the investment income earned (\$376 million) and the average number of days (46 days) that the 457 MA organizations held funds until paying providers for medical services. Appendix A contains details on how we selected the 50 MA organizations and the estimation methodologies that we used.
- We calculated the interest income that the trust funds could have earned if CMS had delayed its prepayments to MA organizations. To make these calculations, we used the total prepayments, the effective annual rates of interest earned by the assets of the trust funds, and the estimated average number of days (46) that the 457 MA organizations held funds until paying providers for medical services.
- We discussed the results of our review with CMS officials on November 5, 2009.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

RESULTS OF REVIEW

Because Federal requirements governing the Medicare Advantage program do not limit the ability of MA organizations to retain investment income earned on Medicare funds, the Medicare program loses potential cost savings. Based on our reviews of 50 MA organizations, the Medicare program continues to lose potential savings because in CY 2007 the 457 MA organizations held Medicare funds for approximately 46 days before paying for medical services. Specifically:

- If Federal requirements had been established to delay the prepayments to MA organizations until after the beginning of the beneficiary's coverage period (similar to the FEHB program) by the same 46 days that MA organizations held Medicare funds, the Medicare Part A and Part B trust funds could have earned approximately \$450 million of interest income in CY 2007.
- Alternatively, if Federal requirements had been established to require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income, the Medicare program could have saved an estimated \$376 million that the 457 MA organizations earned in CY 2007.

In contrast to the Federal requirements that govern the Medicare Advantage program, the FEHB program limits the ability of companies to retain as additional revenue the investment income earned from Federal funds.

Neither of our legislative or regulatory recommendations from our previous audit report was implemented: that CMS either address the timing of its prepayments to MA organizations or

reduce the payment rates by the amount of investment income that the MA organizations earned in CY 1996.

In this context, MA organizations and CMS officials have stated that if either of our previous legislative or regulatory recommendations were to be implemented, some MA organizations would increase their bid proposals to recoup investment income that they would lose. If the MA organizations were to increase their bid proposals to account for the proposed offsets, these higher costs would be recognized in the bid proposals and could result in a possible decrease in our estimated cost savings. However, this could provide greater transparency for program officials. It should be noted that section 1103 of the Health Care and Education Reconciliation Act of 2010, P. L. No. 111-152, has a provision to restrict the total amount of administrative costs reimbursed by CMS to MA organizations. Consequently, this provision may discourage MA organizations from increasing their future bid proposals to recoup investment income that they would lose.

We therefore encourage CMS to study these audit results, consider the impact of the investment income earned on Medicare funds, and review our conclusions and recommendations to improve the economy and efficiency of the Medicare Advantage program.

LACK OF POLICIES REGARDING TREATMENT OF INVESTMENT INCOME IN THE MEDICARE ADVANTAGE PROGRAM

Federal requirements governing the Medicare Advantage program do not limit the ability of MA organizations to retain investment income earned on Medicare funds. Specifically, neither Federal regulations nor CMS guidelines require organizations to include anticipated investment income earned on Medicare funds in their bid proposals.

TREATMENT OF INVESTMENT INCOME IN MEDICARE ADVANTAGE ORGANIZATIONS

As a followup to our 2000 audit of CY 1996 Medicare funds, we performed audits at 50 MA organizations nationwide to (1) determine whether the MA organizations, in their 2007 bid proposals to CMS, reduced their anticipated revenue requirements by any anticipated investment income and (2) estimate the investment income that these 50 MA organizations earned from Medicare funds received in CY 2007.

We found that 48 of the 50 MA organizations did not reduce their anticipated revenue requirements by anticipated investment income in their bid proposals for CY 2007. Two of the MA organizations stated that they made such reductions in their bid proposals. However, only one of these two MA organizations was able to document that it had reduced the amount of anticipated investment income in its 2007 bid proposal. We also found that the 50 MA organizations earned approximately \$179 million of investment income from Medicare funds received in CY 2007.

We used the results of these 50 audits to determine that, in the aggregate, the 457 MA organizations invested Medicare funds in interest-bearing instruments for approximately 46 days before paying providers for medical services.

LOST OPPORTUNITY FOR EARNINGS FOR THE MEDICARE PART A AND PART B TRUST FUNDS

If Federal requirements had been established to delay the prepayments to MA organizations until after the beginning of the beneficiary's coverage period (similar to the FEHB program) by the same 46 days that the MA organizations held Medicare funds, the Medicare Part A and Part B trust funds could have earned approximately \$450 million of interest income in CY 2007.

We calculated this potential interest income with the assumption that the Federal Government would have invested its total prepayments to MA organizations (\$69 billion) in interest-bearing instruments for 46 days at rates equal to the effective annual rates of interest that the Medicare Part A and Part B trust funds earned (5.3 percent and 5.0 percent, respectively) in CY 2007.

LOST OPPORTUNITY FOR COST SAVINGS FOR THE MEDICARE ADVANTAGE PROGRAM

If Federal requirements had been established to require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income, the Medicare program could have saved an estimated \$376 million that the 457 MA organizations earned by investing the prepayments for approximately 46 days in CY 2007.

We estimated the potential savings of \$376 million for the 457 MA organizations using the results of our follow-up audits of 50 MA organizations, in which we found that the 50 MA organizations earned approximately \$179 million of investment income from Medicare funds. Appendix A contains the details of our estimation methodologies.

Under CMS's bid proposal instructions,⁵ CMS provides MA organizations the option to make reductions in their bid proposals for anticipated investment income. However, only 2 of the 50 MA organizations that we audited stated that they made such reductions in their bid proposals. Thus, we conclude that for the Federal Government to recognize savings in this manner, organizations must be required to reduce revenue requirements for anticipated investment income.

TREATMENT OF INVESTMENT INCOME IN THE FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

Unlike the Medicare Advantage program, the FEHB program limits the ability of companies to retain as additional revenue the investment income earned from Federal funds. The U.S. Office of Personnel Management (OPM) pays insurance companies offering managed care coverage through the FEHB program after the start of the employees' insurance coverage periods (as provided for in OPM's FEHB program *Carrier Handbook*, chapter VII). As a result, insurance

⁵ *Instructions for Completing the Medicare Advantage Bid Pricing Tool for Contract Year 2007.*

companies participating in the FEHB program have more limited opportunities to generate investment income than MA organizations do. Moreover, if the possibility of earning investment income exists, OPM's FEHB regulations (48 CFR §§ 1615.470-1 and 1652.215-71) require that a clause be inserted in the FEHB carrier contract that requires the carrier to retain all investment income in the FEHB program's reserves for use in the operation of the FEHB program. (See 5 CFR § 890.503.)

No such policies limit the ability of MA organizations to retain as additional revenue the investment income earned from Federal funds.

PREVIOUS RECOMMENDATIONS NOT IMPLEMENTED

In its comments on our 2000 audit report of CY 1996 Medicare funds, CMS agreed that its policies should hold MA organizations accountable for investment income earned on Medicare funds and should ensure that this investment income is used to benefit Medicare enrollees. However, CMS indicated that it did not intend to propose such legislation.

Our review of CY 2007 Medicare funds demonstrated that MA organizations are still not held accountable for investment income earned on Medicare funds. Although CMS agreed that it needed policies that could hold MA organizations accountable for investment income earned on Medicare funds, neither of our legislative or regulatory recommendations from our previous audit report was implemented: that CMS either address the timing of its prepayments to MA organizations or reduce the payment rates by the amount of investment income that the MA organizations earned.

In this context, MA organizations and CMS officials have stated that if either of our previous legislative or regulatory recommendations were to be implemented, some MA organizations would increase their bid proposals to recoup investment income that they would lose. If the MA organizations were to increase their bid proposals to account for the proposed offsets, these higher costs would be recognized in the bid proposals and could result in a possible decrease in our estimated cost savings. However, this could provide greater transparency for program officials. It should be noted that section 1103 of the Health Care and Education Reconciliation Act of 2010, P. L. No. 111-152, has a provision to restrict the total amount of administrative costs reimbursed by CMS to MA organizations. Consequently, this provision may discourage MA organizations from increasing their future bid proposals to recoup investment income that they would lose.

CONCLUSION

Our findings regarding the Federal requirements governing the Medicare Advantage program for CY 2007 are the same findings that we reported for CY 1996. Specifically, no Federal regulations or guidelines limit the ability of MA organizations to retain investment income earned on Medicare funds. Moreover, for CY 2007, as for CY 1996, the lack of Federal requirements governing treatment of investment income earned within the Medicare Advantage program stood in contrast to the Federal requirements governing the FEHB program. As a result, the financial impact on the Medicare program has increased from CY 1996 to CY 2007. In

CY 1996, the MA organizations held Medicare funds approximately 40 days and earned an estimated \$100 million of investment income. In CY 2007, MA organizations held Medicare funds for a longer period (46 days) and earned significantly more investment income (\$376 million).

We therefore encourage CMS to study these audit results, consider the impact of the investment income earned on Medicare funds in conjunction with its joint efforts with Treasury to improve Treasury's ability to manage cash flow and reduce overall interest costs, and review our recommendations, which identify mechanisms to improve the economy and efficiency of the Medicare Advantage program.

RECOMMENDATION

We recommend that CMS evaluate these audit results and either:

- pursue legislation to adjust the timing of Medicare's prepayments to MA organizations to account for the time that these organizations invest Medicare funds before paying providers for medical services or
- develop and implement regulations that require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income.

CENTERS FOR MEDICARE & MEDICAID SERVICES COMMENTS

In written comments on our draft report, CMS did not concur with our recommendation because, in CMS's judgment, the implementation of either option would cause most MA organizations to increase their bid proposals to recoup the investment income that they would lose. Specifically, CMS said that "[i]f MA organizations were to increase their bid proposals to account for the proposed offsets, these higher costs would be recognized in the bid proposals and would result in a decrease in most or all of the estimated cost savings."

CMS also stated that implementing either option could create an undesirable precedent. CMS assumes that it would be asked to pay interest on the additional Parts C and D payments that CMS frequently makes to MA organizations after the completion of the risk adjustment reconciliation each year. CMS said that "[w]e believe a statutory change would be required to impose such an obligation on CMS" CMS stated that the payment of this interest would result in a further decrease in estimated cost savings.

CMS's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing CMS's comments, we maintain that our findings and recommendation are valid. We agree with CMS's statement that if MA organizations were to increase their bid proposals, our estimated cost savings would be reduced. However, for the following reasons, we disagree

with CMS's assertion that implementing our recommendation would result in a decrease in most or all of the estimated cost savings:

- Section 1102 of the Health Care and Education Reconciliation Act of 2010 will modify the Medicare Advantage payment structure in a way that, according to the Congressional Budget Office, will significantly decrease payments to MA organizations. This modification, coupled with the provision to restrict the total amount of administrative costs reimbursed by CMS to MA organizations (section 1103 of the same legislation), may discourage MA organizations from increasing future bid proposals to recoup investment income that they would lose.
- Market competition may create a disincentive for some MA organizations to increase their bid proposals. MA organizations can provide additional benefits to their enrollees if the MA organizations' bid proposals are below CMS-established benchmarks. However, increases in the bid proposals that either approach or exceed benchmark levels would cause decreases to these additional benefits, thus making those plans less attractive to enrollees. In its report concerning cash management (GAO-09-118), GAO stated that CMS's Office of the Actuary had noted that some MA organizations might be unwilling to increase their bid proposals "if doing so risks losing market share."
- Generally, the Medicare trust funds, through long-term investments, yield higher interest returns than what MA organizations earn with short-term investments. Thus, any decrease in the estimated cost savings caused by increases in MA organizations' bid proposals would be reduced because of the difference between the higher interest earned by the Medicare trust funds and the lower interest earned by MA organizations.

MA organizations invested the prepaid capitation payments for short terms until the funds were needed to pay for medical services. During our review period, the Medicare trust funds earned slightly higher interest rates than the MA organizations did. However, after our review period, the interest rates for short-term investments were significantly less than the effective interest rates for longer-term investments. The short-term commercial paper interest rates for CY 2009 ranged from 0.13 percent to 0.45 percent. By contrast, the Medicare Part A and Part B trust funds, which hold longer-term investments, earned interest in CY 2009 at annual rates of 5.0 percent and 4.4 percent, respectively.

Consequently, even if MA organizations increased their bid proposals to account for lost investment income caused by delayed payments, most of the estimated savings would be maintained because the Medicare trust funds realize higher interest rates on their investments than do the MA organizations.

We agree that if CMS were required to pay interest on additional Medicare Advantage payments made after the risk adjustment reconciliation, the estimated savings we have identified would be reduced. However, it is not clear that Congress would enact legislation to require CMS to pay interest on these additional payments.

APPENDIXES

APPENDIX A: SELECTION OF 50 MEDICARE ADVANTAGE ORGANIZATIONS AND ESTIMATION METHODOLOGIES

SELECTION OF 50 MEDICARE ADVANTAGE ORGANIZATIONS

We selected 50 Medicare Advantage organizations (MA organizations) using both judgmental (30) and random (20) samples. For the 30 judgmentally sampled MA organizations, we selected:

- the top 3 MA organizations, based on the number of Medicare enrollees, for each of the 8 Office of Inspector General (OIG) regions (22 MA organizations)¹ and
- 8 MA organizations based on the availability of OIG resources.

We then selected a random sample of 20 MA organizations from the 427 remaining MA organizations (457 total MA organizations less 30 judgmentally selected MA organizations).

ESTIMATION OF POTENTIAL COST SAVINGS FOR THE MEDICARE ADVANTAGE PROGRAM

We used the results of our 50 audits of MA organizations to estimate the investment income that the 457 organizations earned on Medicare funds during calendar year (CY) 2007. For these audits, we estimated the investment income that the MA organizations earned only on the medical portion of their Medicare funding during 2007. We did not estimate the investment income that MA organizations may have earned on the remaining portions, which were for nonmedical services and gain/loss margins. We did not include any retroactive adjustments made by the Centers for Medicare & Medicaid Services in our estimates of investment income.

In total, the 457 MA organizations earned an estimated \$376 million of investment income from Medicare funds received in CY 2007. This amount consisted of:

- \$165,798,923 earned by the 30 judgmentally selected MA organizations and
- \$210,647,001 earned by the 427 remaining MA organizations (estimated using the results of the 20 randomly sampled MA organizations).

We used the same time periods and interest rates that we found in our review of the 20 randomly sampled MA organizations to estimate the earnings of the 407 remaining MA organizations.

¹ We were not able to review two of the top three MA organizations in two of the OIG regions as a result of a request from the OIG Office of Investigations that we not review certain MA organizations.

CALCULATION OF POTENTIAL EARNINGS FOR THE MEDICARE PART A AND PART B TRUST FUNDS

Estimated Number of Days That Medicare Advantage Organizations Held Medicare Funds

The number of days between the MA organizations' receipt of advance capitation payments (prepayments) from the Centers for Medicare & Medicaid Services and the MA organizations' payments to providers for medical services varied for the 50 MA organizations reviewed. To estimate the average number of days that all 457 MA organizations held Medicare funds in CY 2007 until they paid their providers, we used:

- \$61 billion of prepayments that we estimated that MA organizations used to pay for medical services;²
- \$376 million of estimated investment income; and
- an interest rate of 4.93 percent,³ which we estimated that MA organizations earned when they invested Medicare funds.

Overall, we estimated that the 457 MA organizations held the Medicare funds for approximately 46 days before paying medical providers in CY 2007.

Calculation of Potential Interest Income

We calculated the potential interest income with the assumption that the Federal Government invested its total prepayments to MA organizations (\$69 billion) in interest-bearing instruments for the same 46-day periods and the same annual rates of interest that the Medicare Part A and Part B trust funds earned (5.3 percent and 5.0 percent, respectively) in CY 2007.

Potential Interest Earned by Medicare Trust Funds in Calendar Year 2007

| Trust Fund | Total Payments (in billions) | Effective Annual Interest Rate | Number of Days | Potential Interest Earned (in millions) |
|--------------|------------------------------|--------------------------------|----------------|---|
| Part A | \$35.8 | 5.3% | 46 | \$239 |
| Part B | 33.5 | 5.0% | 46 | 211 |
| Total | \$69.3 | | | \$450 |

²The \$61 billion represents the estimated portion of Medicare funding (from the \$69 billion of prepayments) that MA organizations used to pay for medical services.

³For the 50 selected MA organizations, we used 30-day AA Financial Commercial Paper interest rates obtained from the Federal Reserve to estimate the investment income earned unless the MA organization provided the actual interest rates earned. To calculate the 4.93 percent, we combined results of the 30 judgmentally selected MA organizations and the 427 remaining MA organizations (using the results of the 20 randomly selected MA organizations).

APPENDIX B: CENTERS FOR MEDICARE & MEDICAID SERVICES COMMENTS

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: OCT 28 2010

TO: Daniel R. Levinson
Inspector General

FROM: Donald M. Berwick, M.D. 
Administrator

SUBJECT: Office of Inspector General (OIG) Draft Report: Rollup Review of Investment Income That Medicare Advantage Organizations Earned and Retained From Medicare Funds in 2007 (A-07-10-01080)

Thank you for the opportunity to review and comment on the subject OIG draft report, which aims to estimate the financial impact on the Medicare program of limiting the ability of Medicare Advantage (MA) organizations to retain investment income earned on Medicare funds. The Centers for Medicare & Medicaid Services (CMS) shares the OIG's concern regarding losing potential cost savings associated with the Medicare program. However, we do not agree with the OIG that limiting the ability of MA organizations to retain investment income earned on Medicare funds would result in such savings.

Below is the CMS response to the OIG recommendation in the draft report.

OIG Recommendation

The OIG recommends that CMS review the OIG's audit findings and either: (1) pursue legislation to adjust the timing of Medicare's prepayments to MA organizations to account for the time that these organizations invest Medicare funds before paying providers for medical services, or (2) develop and implement regulations that require MA organizations to reduce their revenue requirements in their bid proposals to account for anticipated investment income.

CMS Response

CMS does not concur with the OIG's recommendation. CMS continues to believe that implementing either option would cause most MA organizations to increase their bid proposals in order to recoup investment income that they would lose. If the MA organizations were to increase their bid proposals to account for the proposed offsets, these higher costs would be recognized in the bid proposals and would result in a decrease in most or all of the estimated cost savings. This fact is identified in the report but not reflected in the savings estimate. Therefore, we feel that the report overstates the significance of this issue since the true savings would be a fraction of the amount cited in the draft report.

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In addition, CMS believes that either option could create an undesirable precedent that results in CMS making additional Part C and D payments to MA organizations. CMS is statutorily required to reconcile the different components of payments to these organizations. After reconciliation is complete, CMS frequently owes plans. For example, risk adjustment reconciliation takes place in August. CMS pays plans additional Part C and D payments based on additional risk adjustment data that we receive from plans. It is reasonable to assume that CMS would be asked to pay interest on these funds if we implemented either option recommended by the OIG. We believe a statutory change would be required to impose such an obligation on CMS, however, if CMS were required to pay interest on these funds, as plans are required to pay or otherwise account for interest on retained Medicare funds, it would likely result in a further decrease in the estimated cost savings.

For these reasons, CMS does not agree with the OIG that limiting the ability of MA organizations to retain investment income earned on Medicare funds would result in savings to the Medicare program.

We appreciate the effort that went into this report. Again, we thank the OIG for the opportunity to review and comment.