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Committee on Oversight and Government Reform:
Subcommittee on Government Organization, Efficiency and
Financial Management; and Subcommittee on Health Care, District
of Columbia, Census and the National Archives

***“Examining the Administration's Failure
to Prevent and End Medicaid Overpayments”***

**Testimony of:
John Hagg
Director of Medicaid Audits**

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Introduction

Good afternoon, Chairman Gowdy, Ranking Member Davis, and other distinguished Members of the Committee. Thank you for the opportunity to testify about the Office of Inspector General's (OIG) recent report involving Medicaid payment rates for State-operated developmental centers in New York. My testimony will provide an overview of the report findings, recommendations, and related work.

Overview

Medicaid payments to developmental centers in New York State far exceed New York's actual costs of providing services to Medicaid beneficiaries.¹

New York claimed \$2.27 billion (\$1.13 billion Federal share) in Medicaid reimbursements to pay for services related to 15 developmental centers in State fiscal year² (SFY) 2009. New York's methodology was not based on actual costs. If New York had used actual costs in its rate-setting methodology, Medicaid reimbursements to the developmental centers could have been as much as \$1.41 billion less in SFY 2009.³ In turn, the Federal Government could have saved as much as \$701 million in that year alone.

Based on the foregoing and previous audits of payments to public providers in other States, OIG recommends that payments to public providers be limited to the actual cost of providing services. This would help ensure that in New York and other States, Medicaid payment methodologies for public providers are reasonable and economical. Until the Centers for Medicare & Medicaid Services (CMS) implements a policy to limit payments to actual cost, it should work with New York to ensure an appropriate Medicaid daily rate for State-operated developmental centers.

¹ *Medicaid Rates for New York State Operated Developmental Centers May Be Excessive*, available at <http://oig.hhs.gov/oas/reports/region2/21101029.asp>.

² New York's fiscal year starts April 1st and ends March 31st.

³ To arrive at this figure, we substituted actual costs for the State-calculated total reimbursable costs.

Background

Medicaid Program

Pursuant to Title XIX of the Social Security Act (the Act), the Medicaid program provides medical assistance to low-income individuals and individuals with disabilities. The Federal and State Governments jointly fund and administer Medicaid. At the Federal level, CMS administers Medicaid. Each State administers its Medicaid program in accordance with a CMS-approved State plan. Although the State has considerable flexibility in designing and operating its Medicaid program, it must comply with applicable Federal requirements, including a provision of the Act that requires that payment for care and services be consistent with efficiency, economy, and quality of care.⁴ The Federal Government pays its share of a State's medical assistance expenditures under Medicaid based on the Federal medical assistance percentage (FMAP), which varies depending on the State's relative per capita income. By law, the FMAP rates cannot be lower than 50 percent. During our audit period, New York had an FMAP ranging from 50 to 58 percent.⁵

New York's Medicaid Program

In New York, the Office for People With Developmental Disabilities (OPWDD) provides services to both Medicaid and non-Medicaid eligible individuals with intellectual and developmental disabilities under a cooperative agreement with the Department of Health (DOH), which administers New York's Medicaid program. In SFY 2009, New York had approximately \$45 billion in Medicaid expenditures, from which the State received \$25 billion in Federal reimbursements.

Intermediate Care Facilities in New York

OPWDD oversees all Intermediate Care Facilities (ICF) for individuals with intellectual and developmental disabilities. These facilities are residential treatment options designed for individuals whose disabilities severely limit their ability to live independently. ICFs provide 24-hour onsite assistance and training, intensive clinical and direct-care services, supervised activities, and a variety of therapies. Developmental and intellectual disabilities include a variety of conditions that cause mental or physical limitation (e.g., autism and cerebral palsy).

⁴ Section 1902(a)(30)(A) of the Social Security Act requires that payment for services be consistent with efficiency, economy, and quality of care.

⁵ Our audit period was April 1, 2008, through March 31, 2009. The American Recovery and Reinvestment Act effectively raised the FMAP for States beginning the first quarter of Federal fiscal year 2009. For October 1, 2008, through March 31, 2009, New York had an FMAP of 58.78 percent because of the enhanced percentage.

ICFs include State-operated and privately operated facilities with 30 or fewer beds and State-operated facilities with more than 30 beds. During our audit period, New York operated 13 facilities with more than 30 beds; it also operated 2 Small Residential Units (SRU)⁶ that provided services to individuals with developmental and intellectual disabilities on the campus of 1 of those 13 larger facilities. Each of these 15 facilities⁷ received the same daily reimbursement rate of \$4,116 per beneficiary in SFY 2009. DOH claimed Medicaid reimbursement on behalf of 1,688 beneficiaries at the developmental centers of \$2.27 billion (\$1.13 billion Federal share). New York's actual costs for the developmental centers totaled \$578 million.

Key State Plan Amendments Affecting Developmental Center Payment Rates

Developmental center payment rates are set using a complex methodology detailed in Attachment 4.19-D, Part II, of New York's Medicaid State plan. The first major revisions to the rate-setting reimbursement methodology for the developmental centers were approved in January 1986, retroactive to April 1984 under state plan amendment (SPA) 84-10. This state plan amendment allowed New York to use a trend factor and volume variance adjustment.⁸ At this point, the rates were on a 2-year cycle. In year 1 of the cycle, rates were based on actual cost reports with yearend volume variance adjustments, while year 2 rates were based on the same cost reports, but trended forward with a volume variance adjustment. The following year, the rates would be readjusted using new cost reports to start the process over.

In 1991, SPA 90-12 was approved,⁹ effectively eliminating the link between actual costs and total reimbursable costs by allowing New York to use base rates set in 1986 to be trended forward. Figure 1 below clearly shows a rapid increase in the rate once this amendment took effect.

Audit Findings

The Growth of Developmental Centers' Rate Significantly Outpaced Those of Other ICFs

The daily rate for a Medicaid beneficiary to reside in a developmental center grew from \$195 per day in SFY 1985 to \$4,116 per day in SFY 2009.¹⁰ The daily rates for all other ICFs in New

⁶ The SRUs have a 12-bed capacity.

⁷ We refer to the 13 State-operated ICFs with more than 30 beds and the 2 state-operated SRUs as "developmental centers."

⁸ The volume variance adjustment ensures that annual decreases in headcount at a developmental center do not cause that center to lose operating funds needed to support its fixed costs. It allows New York to retain 64 percent of the costs associated with beneficiaries no longer in a developmental center.

⁹ The SPA went into effect retroactive to 1990. However, the State considered 1990 a transition year, and the major changes to the reimbursement methodology went into effect in 1991.

¹⁰ The daily rates per beneficiary in SFY 2010 and 2011 were \$4,556 and \$5,118, respectively.

York during SFY 2009 (both State-operated and privately operated), which are based on actual costs, were \$257 to \$902,¹¹ with an average rate of \$444.

Figure 1 compares the growth of the statewide Medicaid daily rate for developmental centers to the rates of three nondevelopmental center ICFs.¹²

Medicaid Daily Rate for Selected Intermediate Care Facilities in New York (1985-2009)

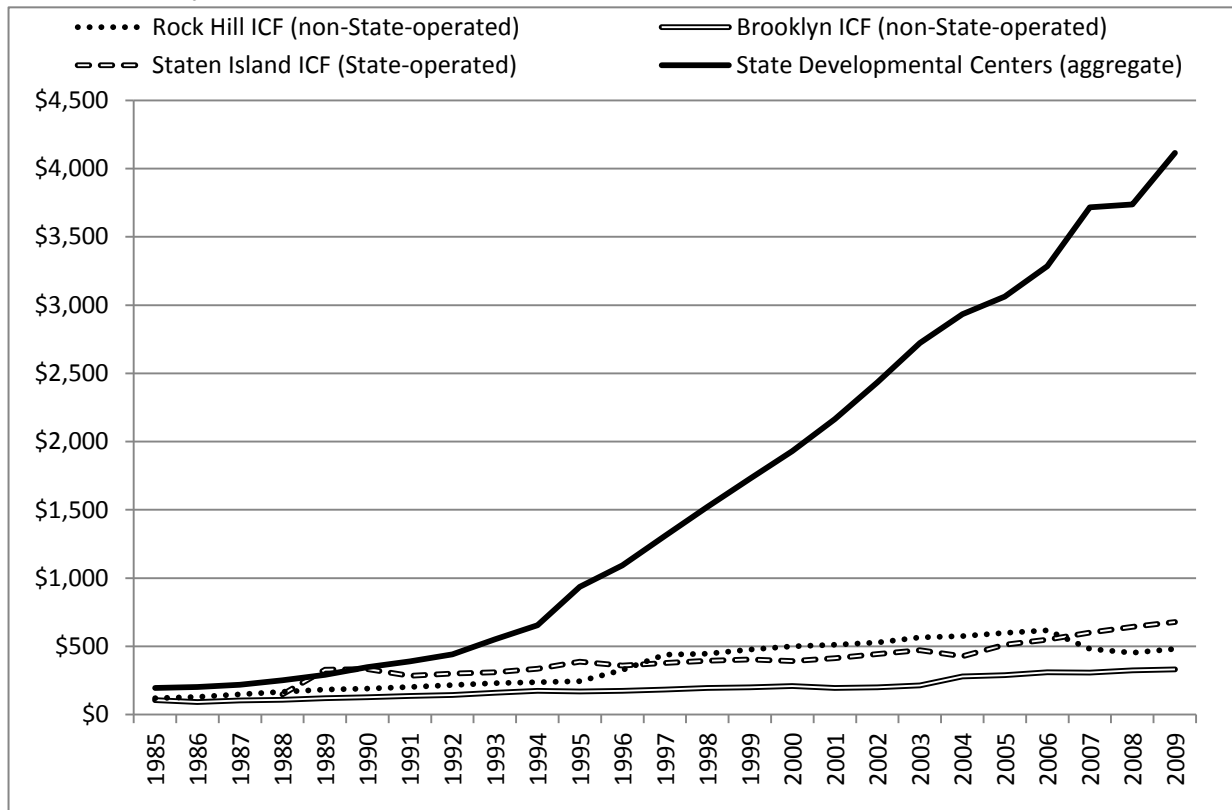


Figure 1

New York Claimed Significantly More for Developmental Center Services Than Its Actual Costs

In SFY 2009, New York claimed nearly \$2.27 billion (\$1.13 billion Federal share) in Medicaid reimbursement for the developmental centers that had an actual cost of \$578 million. Most of the difference between the actual costs and total Medicaid reimbursements is due to New York’s starting point in its rate-setting methodology. New York refers to the starting point as “total reimbursable operating costs.” This figure includes the prior year’s total reimbursable operating costs, a volume variance adjustment, and a trend factor increase. Once adjustments are made to

¹¹ In SFY 2009, there were 519 non-State-operated ICFs with rates that ranged from \$257 to \$776 and 37 State-operated ICFs with rates that ranged from \$476 to \$902.

¹² The three nondevelopmental center ICFs were: (1) a non-State-operated ICF in Brooklyn, New York; (2) a non-State-operated ICF in Rock Hill, New York; and (3) a State-operated ICF in Staten Island, New York.

the starting point, New York also makes several other adjustments¹³ before it calculates a final rate.

We substituted the prior year’s actual costs for the reimbursable operating costs (starting point) to recalculate the Medicaid daily rate in SFY 2009 (see Table 1 for New York’s calculation and OIG’s recalculation). We did not individually assess each adjustment to the reimbursable operating costs in the rate calculation. Therefore, we chose to keep them in our comparison to provide a conservative estimate of possible savings.

New York’s Calculation of Medicaid Daily Rate and OIG’s Recalculation

Rate Component	New York Calculation	OIG Recalculation
Total Reimbursable Operating Costs - 3/31/08	\$1,905,498,278	
Actual Costs for Developmental Centers - 3/31/08		\$580,689,833
Net Adjustments¹⁴	\$399,097,317	\$277,034,766
Total Reimbursable Costs	\$2,304,595,595	\$857,724,599
Number of Beneficiary Days	559,974	559,974
SFY 2009 Medicaid Daily Rate	\$4,116	\$1,532

Table 1

If New York had used prior year actual costs as the starting point to calculate the Medicaid daily rate, its claim for reimbursement would have totaled \$858 million (\$429 million Federal share), a difference of \$1.41 billion (\$701 million Federal share). In addition, the SFY 2009 Medicaid daily rate would have been \$1,532, or 63 percent less than the calculated reimbursement rate of \$4,116.

Privately Operated ICFs Provided Similar Services at a Much Lower Rate

The Medicaid daily rate for developmental centers was substantially higher than the rate for privately operated ICFs, even those that were in similar locations and that offered comparable services.¹⁵ During our audit period, the Medicaid daily rate for each resident of the Brooklyn

¹³ New York has several additions and subtractions to the costs used to calculate the rate. The main additions in SFY 2009 were a provider tax assessment of \$120 million and a health care enhancement fee of \$182 million.

¹⁴ The difference between New York and OIG calculation adjustments is due to the application of percentages used in various stages of the calculation (e.g., provider tax assessment based on 5.5 percent of reimbursements).

¹⁵ As part of our audit work, we randomly selected 10 residents of the Brooklyn Developmental Center (BDC) and 10 residents of a privately operated ICF to review the residents’ Medicaid billing history during our audit period. On the basis of our assessment, we determined that the array of services provided to the residents at the privately operated facility was comparable to that provided to the residents of the BDC; however, the private facility had a rate about one-eighth of the developmental facility.

Developmental Center (BDC), the largest developmental center in New York, was \$4,116. In comparison, the approved Medicaid daily rate for residents of a privately operated ICF that operated three facilities within 10 miles of the BDC ranged from \$421 to \$535 per day, approximately one-eighth of BDC’s rate. See Table 2 below.

Comparison of Reimbursement Rates, Therapies, and Annual Billing Per Resident

	State-Operated Developmental Center	Privately Operated Intermediate Care Facility
Reimbursement Rate(s) ¹⁶	\$4,116 per day	\$421 to \$535 per day
Therapies Included in Reimbursement Rate(s)	Occupational therapy Physical therapy Psychologist services Speech and language pathology Social work Dietetics and nutrition Rehabilitation counseling Nursing services Day treatment	Occupational therapy Physical therapy Psychologist services Speech and language pathology Social work Dietetics and nutrition Rehabilitation counseling Nursing services Day treatment
Annual Billing per Resident	Low: \$1,489,623 High: \$1,502,172	Low: \$99,120 High: \$149,670

Table 2

CMS and New York Should Develop a Reasonable Daily Rate for Developmental Centers

Our report provides a conservative estimate that the Federal Government could have saved approximately \$701 million in SFY 2009 if New York had used actual costs as a starting point in its rate calculation. Over time, the difference between the rate and actual cost has grown and resulted in a rate that would not seem to meet Federal rules of economy and efficiency. CMS and New York should work together to develop a rate that is more reflective of these rules.

Medicaid Payments to Public Providers Should Be Limited to the Actual Cost of Providing Services

The concern about payments to public providers extends beyond payments to New York developmental centers. From 2001 to 2005, OIG audited Medicaid payments to public providers in various States and identified payments far exceeding the cost of care.¹⁷ In some cases, a large portion of the Medicaid payments was not retained by the facilities to provide Medicaid services to Medicaid beneficiaries. Rather, that portion of the Medicaid funds was returned to the State and put to other uses.¹⁸

¹⁶ Rates in the table include ICF or developmental center services and day treatment services.

¹⁷ See *Compendium of Unimplemented Recommendations* at Part III, pp.1-5, available at http://oig.hhs.gov/publications/docs/compendium/2011/CMP-03_Medicaid.pdf.

¹⁸ In 2007, CMS published a proposed rule to, among other things, “limit reimbursement for health care providers that are operated by units of government to an amount that does not exceed the provider’s cost.” The rule was finalized in May 2008, but was ultimately vacated by Federal District Court. See *Compendium* at Part III, p.3.

Based on the foregoing, OIG recommends that reimbursement be limited to an amount that does not exceed the provider's costs.

Conclusion

The Medicaid payment rates for the State-operated developmental centers in New York are extremely high. In SFY 2009, New York claimed more than \$2.27 billion in Medicaid reimbursement for services provided to 1,688 Medicaid beneficiaries in 15 developmental centers. This equaled approximately \$4,116 per day for each beneficiary. The actual cost of the developmental centers was \$578 million.

Based on our recent work in New York involving the State-operated developmental centers and our prior audit work involving Medicaid payments to public providers in other States, OIG recommends that Medicaid payments to public providers be limited to the cost of providing services. This would help to ensure that in New York and other States, Medicaid payment methodologies for public providers are reasonable and economical.

Thank you for your interest in this important issue and the opportunity to be a part of this discussion.

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John Hagg graduated from the University of Dayton, located in Dayton, Ohio, in 1989 with a Bachelor of Science degree in Accounting. Upon graduation, he began his career with the Department of Health and Human Services (DHHS), Office of Inspector General (OIG) as an auditor in the Boston, Massachusetts Regional Office. Later, he transferred to the DHHS/OIG Columbus, Ohio Field Office where he served as a Senior Auditor responsible for health care audits. In November 1999, he was promoted to Audit Manager at the DHHS/OIG Centers for Medicare and Medicaid Audits located in Baltimore, Maryland. Since April 2004, John has served as the Director of Medicaid Audits and is responsible for Medicaid program audits.

During his career, he has received awards in recognition of substantial audit contributions, and has also received letters of appreciation citing excellence in audit performance. In 1999, he received the Inspector General's *Excellence in Financial Management Award* for identifying a \$25.3 million Medicaid account receivable resulting from overpayments involving hospitals and long-term care facilities in one State. In 2001, John received the *Secretary's Award for Distinguished Service* for outstanding accomplishments in addressing concerns involving States' use of upper payment limits that threatened the stability of the Medicaid program. In 2002, John was awarded the *Inspector General's Bronze Medal for Outstanding Employee of the Year*.

John is originally from the State of West Virginia. He has been married for fourteen years and is the proud father of two children.