North Carolina Department of Health and Human Services

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January 21, 2013

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

We have reviewed your report on the findings and recommendations that resulted from the Division of Medical Assistance – Performance audit of the Department of Health and Human Services as outlined in Section 10.9A.(a) through (b) of the 2012-2013 North Carolina State Budget. We appreciate the work you have done on behalf of the people of North Carolina and look forward to our continued work together as we improve the operations of the Division of Medical Assistance. The following represents our responses to the Report Findings and Recommendations.

SUMMARY OF RESULTS

ADMINISTRATIVE FUNCTIONS

Finding #1: The Division has consistently exceeded budgeted amounts for contracted administrative costs and interagency transfers due to an apparent lack of oversight.

General Response: ~~***The Department disagrees with the statement that the cause of exceeded budget amounts is due to lack of oversight. The exceeded budgeted amounts for contracted administrative costs and interagency transfers were due to other factors such as consumption and price; not lack of oversight.***~~ *The Department agrees with this recommendation. The Division will be implementing within the next month a system where we track contract requirements and expenditures on a weekly basis. Under no circumstances will contractors be allowed to exceed the budgeted contract amounts without an approved amendment to the contract. In order to correct historical issues with the budget, we will be requesting a review of our certified budget to ensure that contracted amounts reflect accurate operational costs. For example, the line item for HP services has been held at the 2005 contracted*

amount, however, with the increase in the number of Medicaid eligibilities and providers this contract amount has increased yet is not reflected in the line item for this contract. ~~Since Medicaid is an entitlement program, the Division has little control over consumption.~~

Recommendations:

Beginning in SFY 2013, DMA began tracking contract expenditures to date against total claimed amounts over the term of individual contracts to identify cases where no purchase order is on file, no current claim is in NCAS or the amount is questionable, or the contract is over budget. As a result, three months into SFY 2013, DMA discovered it was already over its certified budget for contracts. While DMA has taken a step in the right direction by tracking costs against certified budget limits, DMA needs to ensure expenditures do not exceed certified budgeted amounts.

DHHS Response: *The Department agrees with this recommendation in concept; however, as discussed in the previous recommendation, the line items for the budget must reflect approved amounts. ~~the process has to begin with a budgeting process that realistically accounts for all changes in baseline expenditures. Contracts have to be rebased annually to account for changes in enrollment and other programmatic changes that are driven by the budget approval process.~~*

~~The Department disagrees that there can be absolute assurance that certified budget amounts will not be exceeded. The Department cannot unilaterally expend funds beyond the budgeted amounts. Contracts are entered into within the state's contract management system with approved amounts, with controls that preclude the expenditure of funds beyond that amount without appropriately approved budget revisions from the Department and OSBM. DMA has repeatedly been instructed during the budgeting process that it cannot rebase contract funds to account for expenditures that will be impacted by enrollment and consumption.~~

Finding #2: Other Department of Health and Human Services (DHHS) division administrative spending is not controlled by DMA and is not sufficiently monitored by DHHS to ensure proper drawdown of federal funds.

General Response: *The Department agrees with the statement that other DHHS division administrative spending is not controlled by DMA. ~~As previously noted, Medicaid is an entitlement program and there is little control over consumption of services. However, the Department does properly monitor drawdowns of federal funds as evidenced by CMS (and other) reviews.~~The Department will develop operating procedures which comply with the recommendation of this audit and as part of the development of the cost allocation plan.*

Recommendations:

DHHS and DMA need to ensure that proper measures are in place to monitor other divisions' Medicaid spending. Interagency memorandums of understanding (IMOU) or cost allocation plans (CAP) should address the Medicaid program costs being necessary for the proper and efficient administration of the Medicaid State Plan and not the responsibility of a non-Medicaid program.

DHHS Response*: The Department partially agrees with the recommendations. DMA provides a pass-through function for other DHHS Divisions to appropriately access federal Medicaid matching funds for administrative functions relating to Medicaid recipients. Other Divisions with administrative services that support the Medicaid program record expenditures in the NCAS in order to draw federal*

funds. The Cost Allocation Branch of the Office of the Controller, in conjunction with Division Budget Offices, maintains comprehensive cost allocation plans (CAPs) to ensure accurate and allowable allocations to the Medicaid program. The CAPs are submitted to the U.S. DHHS Division of Cost Allocation for distribution to Federal partners including CMS for approval. Expenditures that are eligible for Medicaid federal match are included on the CMS 64 report based on amounts recorded in NCAS.

DMA does not directly audit other Divisions' expenditures for accuracy. However, financial reports are available that provide detail of the expenditures. The Division of Medical Assistance will work with the the other Divisions in order to ensure compliance with all Federal and state requirements. Program managers who have only been monitoring program issues will have their role increased to monitor compliance with financial requirements. ~~The permanently assigned CMS Auditors based at DMA on behalf of CMS may perform audits of expenditures. The North Carolina State Auditor prepares an annual Single Audit Report that includes detailed audit work of DMA expenditures.~~

Finding #3: The Department does not have a comprehensive Public Assistance Cost Allocation Plan that can be reviewed from a Medicaid perspective to ensure that costs are allocable and allowable for the proper and efficient administration of the Medicaid State Plan.

General Response: *The Department ~~dis~~agrees with the finding. ~~See prior response to Finding 2 relating to the federally approved Cost Allocation Plan.~~We will develop and implement a Public Assistance Cost Allocation Plan no later than June 30, 2013.*

Recommendations:

DHHS should prepare a department-wide comprehensive PACAP, even if to incorporate the divisional PACAPs through reference. In addition, DHHS should have individuals with a Medicaid programmatic and financial understanding review the comprehensive PACAP to ensure that costs are allocable and allowable for the proper and efficient administration of the State Plan.

DHHS Response*: The Department ~~partially dis~~agrees with the recommendation. ~~Historically, Federal Region IV agencies, CMS and the Division of Cost Allocation (DCA), have agreed to the structure of the Department's cost allocation system. Although one central Public Assistance Cost Allocation Plan (PACAP) for the Department is not compiled, each division utilizing Medicaid funding has a PACAP submitted to and approved by CMS. In consultation with CMS representatives, CMS recommends that the Department move forward in consolidating our plans under the umbrella of DHHS. As to the assurance that costs are allocable and allowable, the accounting system is designed in a manner by which all Medicaid expenditures are readily consolidated at the Department level in financial reports for review. Divisions are responsible for monitoring expenditures and adhering to the federally approved PACAPs which prevents inappropriate cost shifting and inappropriate federal claiming.~~ As discussed above, the Division will implement a PACAPby June 30, 2013.*

Finding #4: DMA does not have a cost allocation plan for appropriately allocating indirect expenditures and tracking expenditures eligible for increased federal funding.

General Response: *The Department agrees with the finding in regards to indirect cost. The Division direct charges expenditures wherever there is a basis to do so. Allocating indirect expenditures would augment the current process.*

Recommendations:

DHHS should reassess their conclusion that a DMA CAP is not necessary. A DMA CAP would serve to allocate costs to all benefiting programs, especially NCHC, as well as support the allocation of Medicaid administrative costs to activities with increased FFP.

DHHS Response*: The Department agrees with the recommendation.* ~~*Historically, Federal Region IV agencies, CMS and the Division of Cost Allocation (DCA), did not require that the Department submit a PACAP for DMA since all costs were direct charged. In recent consultation with CMS representatives, CMS has advised the Department to implement a PACAP going forward.*~~ *. As discussed above, the Division will implement a PACAPby June 30, 2013.*

BUDGET FORECASTING

Finding #1: The Division's budget development and administration practices violate State statutes that have been enacted to ensure agency and legislative accountability for public expenditures.

General Response: *The Department partially agrees with the finding. We disagree the budget development and administrative practices violate State statutes. The Division will implement within 30 days an operational policy where the certified budget is compared to current expenditures by fund and budget code. This report will be updated no less frequently than once a month.*

Recommendations:

1. DMA and DHHS should be required to submit reasonable estimates for all known Medicaid expenditures in their agency budget requests. If expenditures exceed allowable limits, DHHS, the Governor, or the General Assembly should take actions to reduce expenditures to stay within spending caps, rather than omit known expenditures from the budget.

DHHS Response*: The Department* ~~*partially*~~ *agrees with the recommendations. The Division of Medical Assistance (DMA) agrees that reasonable estimates should be requested for all Medicaid expenditures. Beginning immediately, the Division will not only provide estimates for all costs/liabilities anticipated within the Medicaid program but will also provide detailed explainations regarding the expenditures.*~~*The Department disagrees that actions were not taken to reduce expenditiures to stay within budget. Despite the actions taken by the Department, estimates were exceeded, largely due to factors outside the Department's control. Medicaid is an entitlement program and changes require approvals outside of the Division and Department.*~~

2. DMA's agency request budget should adjust expenditures for all known costs that increase or decrease with fluctuations in caseload, including costs in administrative funds 1101 and 1102. These requests should be accompanied by appropriate documentation.

***DHHS Response**: The Department agrees with this recommendation. ~~Historically, DMA has been instructed by the Office of State Budget and Management (OSBM) that rebasing of funds other than 1310 (expenditures for claims and services) would not be approved. Therefore, the Division was advised not to submit either an expansion request or request for rebase. Many of the budget discussions occur in weekly meetings with OSBM and Fiscal Research.~~ Beginning immediately, the Division will not only provide estimates for all costs/liabilities anticipated within the Medicaid program but will also provide detailed explainations regarding the expenditures.*

3. When DMA perceives that the General Assembly has included unachievable savings in their budgets, DMA should provide OSBM with documentation of this at the beginning of the biennium or fiscal year, along with a forecast of the additional total dollars and State General Fund that will be required to cover this unachievable savings.

***DHHS Response**: The Department agrees with this recommendation. ~~In presentations to the Legislature and Medical Care Advisory Committee on more than one occasion, DMA outlined the issues with achieving the budgeted savings. DMA did provide the Department, OSBM and Fiscal Research with information regarding the inability to achieve savings included in the budget for SFY 2012-2013 as early as April 2011.~~ The Division will provide detailed, documented information regarding decisions before the General Assembly in order to inform their choices.*

4. DMA should discontinue the practice of incurring liabilities for the State at the beginning of the fiscal year because they have overdrawn federal funds in the prior fiscal year to offset State General Fund shortfalls.

***DHHS Response**: The Department agrees with this recommendation. ~~DMA does not and can not make unilateral decisions about budgets, cashflow and "the practice of incurring liabilities" independently~~. DMA will work with the Department, OSBM and Fiscal Research to manage cash and expenditures as appropriate. ~~Information that should be kept in context when considering this finding and recommendation is the overall State's budget situation for the last 3 years and the lack of availabilty of funds. The State utilized funds from many sources, including Medicaid, to make required payments for medical services to recipients.~~*

5. Because Medicaid is such a large and complex program with a significant impact on the State budget, DMA may require more oversight than any individual Department Secretary with multiple other divisions and programs can provide. The General Assembly should consider organizational changes that could improve the oversight needed to ensure that the Medicaid program is operated in compliance with legislative mandates.

***DHHS Response:** ~~A decision of this caliber is nature is independent of DMA and is one that the Department, Governor and Legislature must determine. DMA has requested additional resources.~~ The Secretary and the Medicaid Director are committed to ensuring access to any and all information regarding the operations of the Medicaid program.*

Finding #2: The Division's budget forecasting methodology does not allow for reasonable multiyear projections and does not provide an accurate picture of the current year's financial position.

***General Response:** The Department disagrees that the forecasting methodology does not allow for multiyear forecasting. However, the Department agrees that the process can always be improved as to*

budget forecasting methodology. *The Division will improve its budget forecasting methodology. However, given the dramatic changes in the Medicaid program over the next two years, a long-term multiyear projection decreases the accuracy of the forecast.*

Recommendations:

1. DMA should forecast for all Medicaid funds, and these forecasts should be provided in an agreed upon format to OSBM and Fiscal Research Division at least quarterly.

DHHS Response*: The Department agrees with this recommendation*. *We will convene a discussion with OSBM, Fiscal Research and the Department to develop a consistent reporting package that addresses the needs of these entities.* ~~*and has attempted to respond to OSBM and Fiscal Research requests for information.*~~

2. DMA should maintain a comparison of forecasted expenditures and revenues to actual year end budget performance and subject it to analysis that can improve the ability to project expenditures and revenues.

DHHS Response: *The Department agrees with this recommendation. DMA will implement a process that incorporat*~~*ing*~~ *the comparison of forecasts prepared in one period to forecasts prepared in subsequent periods to determine the source of changes in forecasting outcomes creates an opportunity for improvement. DMA prepares detailed analyses every month of variances between actual, forecasts and budget.* ~~*Prior to July 2012, this was done for only 1310 which accounted for over 90% of the state's Medicaid appropriation in state fiscal years 2010, 2011 and 2012. Since July 2012, these analyses have also been prepared for non-1310 funds.*~~

3. DMA should prepare a five-year analysis to contribute to the Governor's budget message and should routinely forecast expenditures and revenues for a minimum of three years in the future.

DHHS Response: *The Department agrees with this recommendation.* ~~*However,*~~*As discussed previously the Division will improve its budget forecasting methodology. However, given the dramatic changes in the Medicaid program over the next two years, a long-term multiyear projection decreases the accuracy of the forecast.* ~~*in an enviroment as dynamic as Medicaid, such long-term projections may be subject to significant error based on the number of assumptions that have to be made. DMA will prepare forecasts as requested by the Department, Governor and Legislature. The tools and processes employed by DMA have the ability to produce forecasts beyond the two year biennium practice. DMA will consider this recommendation in consultation with the parties that utilize forecasts of DMA expenditures and make appropriate changes.*~~

Finding #3: The Division of Medical Assistance does not appropriately manage Medicaid costs that are subject to agency control.

General Response: *The Department partially disagrees with the finding.* ~~*Although Medicaid costs are well managed, we recognize there are opportunities for improvement.*~~

Recommendations:

1. Because caseload is a significant cost drive for Medicaid, DMA should perform multiyear caseload projections to support multiyear expenditure forecasts, and these forecasts should be tracked against actual caseload growth to evaluate the accuracy of the forecasting methodology.

DHHS Response: *The Department agrees with the recommendation. DMA provides a multiyear caseload projection utilizing the Statistical Analysis System (SAS) statistical forecasting tool. We will enhance the caseload forecasting to support multiyear expenditures. Should it be determined that the Department, OSBM and the Legislature require forecasts beyond the 2 year biennium cycle, DMA will implement an extension of the forecast to accommodate whatever time period is requested.*

2. DMA should perform a study to evaluate reimbursement methodology reform which should have a goal of establishing stable reimbursement methodologies that do not increase automatically, but are only increased by actions approved by the General Assembly.

DHHS Response: *The Department agrees with this recommendation. Payment reform is a critical long term issue for the NC Medicaid program. The reform should include the design of a Medicaid program that defines the health outcomes and objectives of the state, including a payment system that supports the achievement of those goals.*

3. The State of North Carolina should engage medical researchers to perform a scientifically valid study based on actual data to determine whether the CCNC model saves money and improves health outcomes.

DHHS Response: *The Department ~~does not~~ agee~~s~~ with this ~~recommendation because the Department already engages such researchers~~. ~~Currently, DMA annually engages a national actuarial consulting firm with extensive experience in the health care and health insurance industries to apply actuarial science to determine what savings have occurred as a result of the Community Care of North Carolina (CCNC) program. DMA also participates in the Healthcare Effectiveness Data and Information Set (HEDIS) report, which is used by Health Maintenance Organizations (HMO's) and Health Insurance companies nationally in comparing clinical outcomes and processes. DMA will utilize the results of the researchers studies as a part of its annual review of CCNC performance.~~ As we work to control costs and improve quality within the Medicaid program it is critically important that the data available be analyzed by a reputable research organization to assist in informing change.*

4. Actions should occur, probably from outside the agency, to enforce a change in Division organizational culture to provide a focus on a health insurance perspective that encourages cost containment in an environment of increasing medical services and expanding payments to providers.

DHHS Response: *The Department agrees with this recommendation. ~~However, the recommendation should be inclusive of the Executive and Legislative Branches of the NC State Government. Establishing a clearly defined role for the NC Medicaid program as a health insurance program, rather than merely a government entitlement program or a jobs engine for the NC economy, is the first step.~~The Secretary and Medicaid Director are committed to providing the leadership and tools necessary to ensure the proper staffing and focus for this health insurance program.*

Finding #4: DMA failed to comply with a legislative mandate to eliminate inflationary increases for nursing facilities.

General Response: *The Department agrees with the finding.* ~~*The failure to eliminate inflationary increases for nursing homes resulted from the Department's inability to obtain a timely State Plan Amendment.*~~*The Division will ensure compliance with any and all state and federal mandates.*

Recommendations:

DMA should give complete and accurate information to the General Assembly when seeking approval to violate legislative mandates. Approval by the General Assembly should occur in a recognized forum with authority to provide this approval, rather than in informal discussions with individual legislators.

DHHS Response*: As stated above, the Division will ensure compliance with any and all state and federal mandates. In addition, we will maintain complete transparency with the General Assembly regarding issues and financing of the Medicaid program.* ~~*The Department plans to both follow State law and provide complete and accurate information to the General Assembly. The reimbursement system provides for a quarterly adjustment in each nursing home's direct care rate for changes in average "acuity" case mix. This change will increase or decrease the rates for the subsequent quarter. The reimbursement system provides for a quarterly adjustment in each nursing home's direct care rate for changes in average "acuity" case mix. This change will increase or decrease the rates for the subsequent quarter.*~~

~~*The rebase is founded on enrollment, changes in consumption and changes in rates. The first element of the rebase is developed at a macro¯level¯for each program aid category. The second element is unique to each category of service and reflects changes in the proportion of the enrolled population accessing each individual service. The final element quantifies the impact of reimbursement systems that results in increases or decreases in rates that are not controlled by the budget approval process without a change in the reimbursement system and State Plan.*~~

~~*In the case of nursing homes, the base rates reflect the current cost per member per month (PMPM). Changes in the case mix in the upcoming year will increase or decrease the PMPM rates. The rebase attempts to assign a value to the expected changes in case mix based on history. Therefore, without a change in the State Plan, the reimbursement system will allow for changes in direct care rates based on changes in case mix, that were included in the rebase under the section entitled "inflation".*~~
~~*The Case Mix Index (CMI) is the only acuity base factor in the rate system for nursing home payments. Freezing or eliminating the CMI would result in nursing homes not being reimbursed based on acuity of their patients. Additionally, there has not been an inflationary adjustment to the Market Basket Index used in nursing home rates in at least 3 years. The State Auditor/consultant incorrectly states that the base year for nursing homes "usually moves forward each year" and that "adjusted costs receive an inflationary adjustment each quarter based on the Skilled Nursing Facility Market Basket published by Global Insight". The State Auditor/consultant also incorrectly stated that the Direct Care Ceiling is set at 102.6%. It is currently set at 100%.*~~

State Plan Amendments

Finding: The cost savings incorporated into the budget for specific State Plan Amendments (SPAs) are not always realized due to varying factors - some within DMA's control.

General Response: *The Department agrees with the finding.*

Recommendation:

1. The savings incorporated into the state budget need to be more realistically calculated by the DMA and DHHS with consideration of costs of implementation and realistic implementation dates given current system constraints.

DHHS Response*: The Department agrees with the recommendation and will review ways to improve calculations of cost savings.*

REPORTING

Finding: Medicaid reports do not provide easily understood and timely data.

General Response: *The Department agrees with the finding and will attempt to make reports more reader friendly. We will work with OSBM and Fiscal Research to ensure a more user friendly report(s)*

Recommendations:

1. DMA should consult with the DHHS Secretary, Office of the Governor, OSBM, and Fiscal Research Division of the North Carolina General Assembly to determine the informational needs of those charged with governance over the State's Medicaid program. Medicaid reporting requirements, including report formats and timeframes, should be formally established and followed.

DHHS Response*: The Department agrees with the recommendation.*

2. Once reporting formats and timeframes have been established, the DHHS Secretary should ensure DMA is held accountable for providing accurate and timely reports to stakeholders.

DHHS Response*: The Department agrees with the recommendation.*

If you need any additional information, please contact Monica Hughes at (919) 855-3720.

Sincerely,

Dr. Aldona Wos

AW:mh

cc: Beth Melcher, Chief Deputy Secretary for Health Services
Dan Stewart, Assistant Secretary for Finance and Business Operations
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