DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF AUDIT SERVICES
233 NORTH MICHIGAN AVENUE
CHICAGO, ILLINOIS 60601

REGION V
OFFICE OF
INSPECTOR GENERAL

Report Number: A-05-05-00018 February 27, 2006

Ms. Janet Olszewski
Director
Michigan Department of Community Health
320 South Walnut Street
Lansing, Michigan 48913

Dear Ms. Olszewski:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Medicaid Support for Graduate Medical Education in the State of Michigan." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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Please refer to report number A-05-05-00018 in all correspondence.

Sincerely,

Paul Swanson

Paul Swanson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Ms. Verlon Johnson
Associate Regional Administrator
Division of Medicaid and Children's Health
Centers for Medicare & Medicaid Services
Department of Health and Human Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601-5519

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF MEDICAID SUPPORT FOR GRADUATE MEDICAL EDUCATION IN THE STATE OF MICHIGAN

Daniel R. Levinson
Inspector General

FEBRUARY 2006
A-05-05-00018

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

The Office of Management and Budget requested that we review Medicaid payments to hospitals for medical education because of concerns regarding the growth of the payments and questions about whether Medicaid funds were involved in intergovernmental transfers.

Under the Social Security Act, Medicare is required to fund the graduate medical education program. Under Medicaid, States may elect to participate in this program, subject to approval by the Centers for Medicare & Medicaid Services (CMS). The Medicaid program offers more flexibility than Medicare in that States have latitude in determining how to best use available funds.

Similar to Medicare, Michigan pays hospitals for Medicaid graduate medical education under two categories: (1) direct medical education (DME) and (2) indirect medical education (IME). Payments for DME are intended to help cover costs incurred by a hospital for medical residents and teaching faculty, including salaries, fringe benefits, and allocations of overhead. A hospital reports the total costs it incurs for DME under separate items on its Medicare cost report. Payments for IME are unlike payments for DME in that no corresponding cost items are reported by the hospital on its Medicare cost report. The costs are therefore not precisely defined or quantified.

Our review covered fiscal year 2000, when Medicaid provided $184.5 million in graduate medical education payments (including about $102.8 million in DME payments and about $81.7 million in IME payments) to 51 teaching hospitals in Michigan.

OBJECTIVES

Our objectives were to analyze Michigan's Medicaid graduate medical education payment formula and the methods used by Michigan to establish the amount of funds that individual hospitals will receive and to determine whether (1) Michigan followed the approved State plan in administering the Medicaid graduate medical education program and (2) intergovernmental transfers included any program funds.

SUMMARY OF FINDINGS

Payment Methodology

Our analysis of Michigan's graduate medical education payment formula and the methods used to determine the amount of funds that hospitals receive showed that the payments were generally not based on the hospitals' current needs. Furthermore, the total level of funding had remained unchanged since 1997. Although DME payments of $82.8 million were based on costs reported on the hospitals' 1995 Medicare cost reports,

IME payments of $81.7 million were based on formula calculations from non-cost data. Payments for DME were also allocated to eligible hospitals from an additional $20 million cost pool. The annual amount of $20 million for this pool was established in 1997. Except for the instance cited below, payments were made in accordance with State plan provisions.

Noncompliance With State Plan

Contrary to the State plan, the State used $1.7 million ($955,060 Federal share) in graduate medical education funds for other Medicaid services. Also, rather than making the required fixed, semimonthly payments, the State paid 82 percent ($152 million) of the total funds during the first 32 days of the fiscal year. As a result of early payments, the government lost the opportunity to earn about $4 million in interest on funds drawn early. In addition, the State did not ensure that hospitals accounted for their use of funds by submitting required annual reports.

Graduate Medical Education Funds Were Not Involved in Intergovernmental Transfers

Intergovernmental transfers between publicly owned hospitals and the State did not involve graduate medical education funds. Rather, intergovernmental transfers were funded by specific State appropriations. Although Federal regulations specify that public funds may be considered as the State's share if the funds are transferred from other public agencies to the State or local agency and under its administrative control, our prior audits of other types of Medicaid payments identified patterns of abuse. This was not the case for publicly owned hospitals that received graduate medical education funds from Michigan.

RECOMMENDATIONS

We recommend that Michigan:

- report a $955,060 financial adjustment to CMS for the Federal share of graduate medical education funds used for other Medicaid services,
- adhere to the payment method presented in the approved State plan, and
- ensure that hospitals comply with reporting requirements of the State plan.

STATE'S COMMENTS

State officials did not agree to repay the $955,060 in graduate medical education funds used for other Medicaid purposes. While agreeing that these funds had not been used for graduate medical education, they said there was no evidence that the funds had been used for ineligible services that would require a financial adjustment.

State officials concurred with our recommendations that Michigan adhere to the payment method presented in the approved State plan and ensuring that hospitals comply with the reporting requirements of the approved State plan.

We have attached the State's comments in their entirety as an appendix.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We continue to recommend that the State refund $955,060 to the Federal government. The funds were not distributed to eligible hospitals for graduate medical education as required by the State plan amendment, section III.J.

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INTRODUCTION

BACKGROUND

The Office of Management and Budget requested that we review Medicaid payments to hospitals for medical education because of concerns regarding the growth of the payments and questions about whether Medicaid funds were involved in intergovernmental transfers.

Medicaid Program

Medicaid was established in 1965 under Title XIX of the Social Security Act as a jointly funded Federal-State program to provide medical assistance to qualified low-income persons. Each State administers its Medicaid program in accordance with a State plan approved by the Centers for Medicare & Medicaid Services (CMS), which is responsible for the program at the Federal level. In Michigan, the Department of Community Health, the State Medicaid agency, administers the program.

With Federal approvals, State agencies decide whether to cover optional services and how much to reimburse providers for a particular service. The Federal Government pays its share of Medicaid expenditures according to a defined formula, which yields the Federal medical assistance percentage. During fiscal year 2000, the Federal percentage for Michigan was 55.11 percent; the State provided the remaining 44.89 percent.

Graduate Medical Education

Medicare is one of the traditional funding sources for graduate medical education. Medicare funding is authorized under sections 1886(h) of the Social Security Act. In contrast to Medicare, Medicaid does not mandate funding of graduate medical education. Nevertheless, almost all States have opted to provide such funding.

In 1997, Michigan filed a State plan amendment and obtained CMS approval to pay Medicaid graduate medical education funds to teaching hospitals. The State funds this program with general budget appropriations through the State Medicaid agency. The program is based on the Medicare design; funds are distributed based on formulas that consider the number of residents and other characteristics of each hospital's teaching program. Similar to Medicare, Michigan funds Medicaid graduate medical education under two categories: (1) direct medical education (DME) and (2) indirect medical education (IME).

Payments for DME are intended to help cover a hospital's costs for medical residents and teaching faculty, including their salaries, fringe benefits, and allocations of overhead. A hospital reports the total costs it incurs for DME under separate items on its Medicare cost report.

Payments for IME[1] are unlike payments for DME in that no corresponding cost items are reported by the hospital on its Medicare cost report. The costs are therefore not precisely defined or quantified by the hospitals.

The State had three pools of graduate medical education payments: Historical Cost Pool, Primary Care Pool, and Innovative Grants Pool. The Innovative Grants Pool was not covered by our audit. (Grants from this pool, totaling up to $10 million, were awarded to seven consortiums or hospitals.) Payment data for the Historical Cost Pool and the Primary Care Pool was available in a document titled "Medical Education Reimbursement." The breakdown of total payments for DME and IME from these two pools was, as follows:

	DME	IME	Total
Historical Cost Pool	$82,802,464	$81,657,111	$164,459,575
Primary Care Pool	$20,000,000	0	$ 20,000,000
	$102,802,464	$81,657,111	$184,459,575

Intergovernmental Transfers

In certain circumstances, Medicaid allows the use of public funds (funds from county-, city-, or State-owned facilities) as the State's share of financial participation. According to 42 CFR § 433.51, public funds may serve as the State's share for drawing Federal funds if the public funds are appropriated directly to the State or local Medicaid agency or are transferred from other public agencies to the State or local agency and under its administrative control. Our prior audits of other types of Medicaid payments found that some States abused this provision. For example, some States required county providers to return Medicaid payments to the State through the use of intergovernmental transfers. These States, in some instances, then used the funds for non-Medicaid purposes.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to analyze Michigan's Medicaid graduate medical education payment formula and the methods used by Michigan to establish the amount of funds that individual hospitals will receive and to determine whether:

- Michigan followed the approved State plan in administering the Medicaid graduate medical education program, and

- intergovernmental transfers included any program funds.

[1] Indirect Medical Education should not be confused with indirect costs, i.e., allocations of overhead paid under Direct Medical Education.

Scope

Our review of Michigan's payment formulas and methods for distribution of graduate medical education funding to 51 teaching hospitals covered fiscal year 2000. These hospitals received a total of $184.5 million from the program (including approximately $102.8 million for DME payments and about $81.7 million for IME payments) in fiscal year 2000.

For the purpose of this review, we excluded the Medicaid payments for grants from Medicaid DME revenue, since these grant payments represent payments for providing or developing health profession training in managed care settings. Grants were awarded to consortiums, which included at a minimum a hospital, university and a managed care organization.

Our review of compliance with the State plan covered fiscal year 2001. We visited 7 of the 51 hospitals to verify the receipt of funds and to evaluate the hospitals' accountability for these funds. These 7 hospitals accounted for 64% of the total graduate medical education payments.

We also determined whether intergovernmental transfers were used for program funding.

Our review of internal controls was limited to the State agency's procedures for administering the Medicaid graduate medical education program and the hospitals' procedures for verifying receipt and accounting for funds. We performed fieldwork at the State agency, selected hospital facilities, and the Medicare fiscal intermediary.

Methodology

To determine payment formulas and methods used for distribution of graduate medical education funding, we reviewed the State plan amendments and discussed distributions with State officials.

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We determined whether graduate medical education funds were distributed in accordance with the approved State plan by obtaining from the State agency supporting documentation for payments to the 51 hospitals and verifying receipt of the payments at the 7 hospitals visited. We reconciled the total Medicaid funds paid in 2001 to the CMS 64 and resolved discrepancies with State agency personnel and hospital staff.

Two of the seven teaching hospitals that we visited were publicly owned. To determine whether graduate medical education funds were used for intergovernmental transfers, we reviewed the two hospitals' records for any transfers. (The third public hospital in the State did not receive significant funding.)

We conducted the audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Our analysis of Michigan's graduate medical education payment formula and the methods used to determine the amount of funds that hospitals receive showed that the payments were generally not based on the hospitals' current needs. Furthermore, the total level of funding had remained unchanged since 1997. Of the $102.8 million in payments for DME, $82.8 million was paid from the Historical Cost Pool based on Medicaid cost data taken from 1995 Medicare cost reports. The remaining $20 million in DME payments was paid from the Primary Care Pool, a pre-established pool of money that was allocated among the hospitals. In contrast, IME payments totaling $81.7 million were based on formulas that used non-cost data taken from 1995 Medicare cost reports, such as the number of full-time-equivalent (FTE) primary care interns and residents, as well as indigent care utilization rates. The State's IME formula was similar to, but did not mirror, the Medicare IME formula.

We also found that:

- the State did not always comply with the State plan and

- Medicaid graduate medical education funds were not included in intergovernmental transfers between the State agency and two publicly-owned teaching hospitals.

PAYMENT METHODOLOGY

Michigan's Medicaid payment methodology for graduate medical education for fiscal year 2000 was implemented effective July 1, 1997. Annual funding levels under this methodology remained unchanged through calendar year 2001.[2] Payments were made prospectively in fixed amounts and were not subject to future cost settlement or appeal. To qualify for payments from the Historical Cost Pool or from the Primary Care Pool, hospitals must have operated a graduate medical education program.

Historical Cost Pool

Of the total $164.5 million for the Historical Cost Pool, $82.8 million was paid for DME and $81.7 million was paid for IME. The $82.8 million in DME payments were based on actual inpatient and outpatient cost data reported on the hospitals' 1995 Medicare cost reports. The number of FTEs was not used in the computation. The $81.7 million in IME payments were calculated by formula using non-cost data taken from the 1995 Medicare cost reports. The formula included the number of FTEs, an indigent adjustment factor, and other adjusting factors established by Michigan. The IME formula was similar to Medicare, in that FTEs and indigent adjustors were utilized to compute the IME payments. The IME formula, however, was not identical to Medicare.

[2] Michigan revised its payment methodology effective with calendar year 2002. Payments are now entirely based on formula with no consideration to historical DME costs.

Primary Care Pool

The Primary Care Pool ($20 million) was paid to hospitals for DME only. The $20 million annual amount for this pool was established in 1997 based on budgetary considerations. The pool was allocated to eligible hospitals based on the number of FTE primary care interns and residents weighted for Medicaid utilization.

Except for the instance cited below, payments were made in accordance with State plan provisions.

NONCOMPLIANCE WITH STATE PLAN

Funds Used for Other Purposes

The State plan amendment at section III.J requires that in the event the full amount of the Innovation Grants Pool is not awarded, the balance is to be transferred to the Primary Care Pool and distributed to hospitals eligible to receive graduate medical education funds. Contrary to this requirement, the State used $1.7 million ($955,060 Federal share) of graduate medical education funds from the Innovation Grants Pool for other Medicaid services during fiscal year 2001.

Early Funds Disbursement

The State plan amendment at section III.J requires semimonthly payments to hospitals from the Historical Cost and Primary Care Pools (that is, 24 equal payments during the academic year). However, the State disbursed 82 percent ($152 million) of the total graduate medical education funds during the first 32 days of the fiscal year.

To pay hospitals early, the State drew down Federal funds early. As a result, the government lost the opportunity to earn interest on funds drawn early. We estimate that interest lost to the Federal government was about $4 million.[3] We noted that the State paid the Federal and State funds to hospitals within 24 hours of the drawdown of Federal funds and did not benefit from drawing Federal funds early.

Unfiled Hospital Reports

The State plan amendment at section III.J states:

> To be eligible to receive a payment from the historical cost/primary care formula pools, a hospital is required to submit a report to the MSA [Medicaid State agency] each year. The reports shall include . . . a description of how the Medicaid funds from the pools are being used in the support of the "Guiding Principles of Medicaid Payment Policy for Health Professions Education". . . .

[3] For purposes of computing the lost interest, we used the rates applicable to Medicare overpayments in 2000.

The State's policy bulletin (MSA 96-15) further states that "Medicaid payments for health professions education should be made with an expectation for accountability in the use of the funds, so those making payments can identify what is being purchased with public dollars."

None of the seven hospitals that we visited filed required reports showing the use of Medicaid graduate medical education payments. The State did not monitor the hospitals by requiring the submission of these reports and, therefore, lacked assurance that funds were used to only pay for program related activities.

GRADUATE MEDICAL EDUCATION FUNDS WERE NOT INVOLVED IN INTERGOVERNMENTAL TRANSFERS

The Office of Management and Budget requested that we determine whether publicly owned hospitals that received Medicaid graduate medical education funds had later transferred any part of those funds back to the State. Medicaid regulations at 42 CFR § 433.51 specify that public funds (funds from county-, city-, or State-owned facilities) may serve as the State's share for drawing Federal funds if the public funds are transferred from other public agencies to the State or local agency and are under its administrative control. Our prior audit work, targeting other types of Medicaid payments, identified instances in which States required publicly-owned hospitals to transfer the State-funded portion of certain Medicaid payments back to the State agency. States could then use the funds for other purposes.

We determined that intergovernmental transfers between publicly owned hospitals and Michigan did not involve Medicaid graduate medical education funds. Rather, intergovernmental transfers were funded by specific State appropriations.

RECOMMENDATIONS

We recommend that Michigan:

- report a $955,060 financial adjustment to CMS for the Federal share of graduate medical education funds used for other Medicaid services,
- adhere to the payment method presented in the approved State plan, and
- ensure that hospitals comply with reporting requirements of the State plan.

STATE'S COMMENTS

State officials did not agree to repay the $955,060 in graduate medical education funds used for other Medicaid purposes. While agreeing that these funds had not been used for graduate medical education, they said there was no evidence that the funds had been used for ineligible services that would require a financial adjustment.

State officials concurred with our recommendations that Michigan adhere to the payment method presented in the approved State plan and ensuring that hospitals comply with the reporting requirements of the approved State plan.

We have attached the State's comments in their entirety as an appendix.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We continue to recommend that the State refund $955,060 to the Federal government. The funds were not distributed to eligible hospitals for graduate medical education as required by the State plan amendment, section III.J.

APPENDIX

STATE OF MICHIGAN
DEPARTMENT OF COMMUNITY HEALTH
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

JANET OLSZEWSKI
DIRECTOR

December 22, 2005

Mr. Paul Swanson
Office of Audit Services
Department of Health and Human Services
233 North Michigan Avenue
Chicago, Illinois 60601

RE: Report Number A-05-05-00018

Dear Mr. Swanson:

Enclosed is the Michigan Department of Community Health (MDCH) response to the draft report entitled "Review of Medicaid Support for Graduate Medical Education in the State of Michigan". We disagree with your recommendation that we report a $955,060 financial adjustment to CMS for the Federal share of graduate medical education funds used for other Medicaid services. Our position on this issue remains the same as it did when we filed comments on a previous report of the same title in June of 2003 (A-05-02-00081).

We appreciate the opportunity to comment on the report before it is released. Please contact Brian Keisling at (517) 241-7181 if you have any questions.

Sincerely,

Paul Reinhart, Director
Medical Services Administration

Enclosure

Review of Medicaid Support for Graduate Medical Education In the State of Michigan

MDCH Response

Finding: Funds Used for Other Purposes

Recommendation: That Michigan report a $955,060 financial adjustment to CMS for the federal share of graduate medical education funds used for other Medicaid services.

Consistent with our June 2003 response, MDCH agrees that it did not transfer $1.7 million in unspent Innovation Grants Pool funding to the Primary Care Pool for distribution to the eligible hospitals receiving Medicaid GME funds. We also still do not agree that the funds were used for other ineligible Medicaid services. Consequently, MDCH again takes exception to the recommendation that it make a financial adjustment of $955,060 for the federal share of the $1.7 million in Medicaid GME funds allegedly used for other Medicaid services. Had the funds been used to fund other Medicaid services, they would have been for a legitimate Medicaid expenditure and would have been in accordance with the approved State Plan. There is still no evidence that MDCH spent any of the $1.7 million for ineligible Medicaid services that would require a financial adjustment.

Finding: Early Funds Disbursement

Recommendation: That Michigan adhere to the payment method presented in the approved State plan.

Consistent with our June 2003 response, MDCH agrees with the finding that it disbursed 82% of the total GME funds to the hospitals during the first 32 days of the fiscal year. MDCH also agrees with the recommendation that Michigan adhere to the payment method presented in the approved State plan. Effective 1/1/02 Michigan's approved State plan no longer contains the requirement that GME payments be made in 24 equal payments during the academic year. As a matter of State policy, GME funding is now disbursed in four equal quarterly payments.

Finding: Unfiled Hospital Reports

Recommendation: That Michigan ensure that hospitals comply with reporting requirements of the State plan.

MDCH agrees with the recommendation and the finding that cited MDCH for not ensuring that the hospitals filed the required reports. MDCH agrees that it needs to ensure that hospitals comply with the reporting requirements contained in the approved State plan.