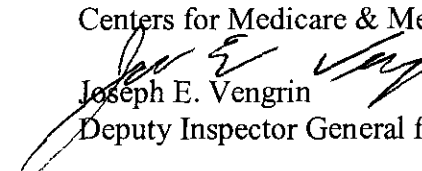




JUL 26 2004

TO: Leslie Norwalk
Deputy Administrator
Centers for Medicare & Medicaid Services

FROM: 
Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Related-Party Management Fees Reported by Four Medicare+Choice Organizations in a Chain (A-06-01-00033)

Attached are two copies of our final report entitled "Review of Related-Party Management Fees Reported by Four Medicare+Choice Organizations in a Chain."

Medicare regulations require that Medicare+Choice organizations (MCO) provide the Centers for Medicare & Medicaid Services (CMS) with information on their cost of operations, fiscal soundness, significant business transactions, premiums, and cost sharing. Reporting requirements for significant business transactions, including related-party transactions, are addressed in 42 CFR § 422.516. Information relating to premiums and cost sharing is presented in adjusted community rate proposals (proposals) and addressed in 42 CFR §§ 422.306 and 422.310.

We examined the 1999 financial disclosure reports and the 2001 proposals of four MCOs. Because these MCOs were wholly owned subsidiaries of United HealthCare Services, Inc. (United), the MCOs and United were "related parties." The MCOs' 2001 proposals were based on 1999 cost data, including costs reported on their 1999 financial disclosure reports. The proposals contained a total of more than \$100 million in related-party management fees (which are considered administrative costs) paid to United in return for administrative services.

Our objective was to determine whether related-party management fees that the MCOs reported in their 1999 financial disclosure reports and 2001 proposals were based on appropriately allocated, actual costs.

For the more than \$100 million of related-party management fees:

- The MCOs did not show in their financial disclosure reports that the related-party management fees did not exceed the costs that would have been incurred with an unrelated party. The MCOs reported the amounts paid to United but did not disclose the actual costs of services provided by United or the costs that would have been incurred with an unrelated party. Thus, the MCOs were not in compliance with the financial disclosure requirements of 42 CFR § 422.516.

- The MCOs did not have effective procedures to develop and compile data on the costs of their operations. As a result, we could not determine whether the administrative costs reported in the proposals represented a fair distribution of costs. This is required by proposal instructions, and we believe it would be essential in reporting administrative costs to CMS. We could not identify the actual costs of services provided by United because the company did not have a cost accounting system capable of allocating costs by lines of business (such as Medicare, Medicaid, and commercial business). Also, because the MCOs did not base management fees on actual costs, we could not be assured that the fees did not include related-party profits.

We are making the following recommendations, modified to address CMS's comments:

1. CMS should evaluate, based on financial disclosure requirements, the four MCOs' process for developing administrative costs in their proposals and apply administrative sanctions,¹ if appropriate, against these and other United plans. At a minimum, CMS should require United to support the administrative costs allocated to individual plans in the form of management fees.
2. CMS should review financial disclosure reports and proposals for years after 1999 to determine if the MCOs have adequate supporting documentation for management fees.
3. CMS should develop review procedures to ensure that MCOs are in compliance with related-party financial disclosure requirements of 42 CFR § 422.516.
4. CMS should consider requiring home offices of chain MCOs to file an annual cost statement for each plan that shows total actual home office costs and the Medicare share of those costs. Total home office costs should be reconciled to the chain's consolidated financial statements prepared using generally accepted accounting principles (GAAP) to ensure that related-party profits are eliminated and that each plan's Medicare share is reported in its proposal.

CMS agreed that it needed to reevaluate financial disclosure reports and provide revised instructions, as necessary, to ensure that MCOs are in compliance with related-party financial disclosure requirements. However, CMS believed that (1) levying administrative sanctions or requiring a corrective action plan would not be an effective use of time or resources, (2) attempting to establish an accurate assessment of related-party arrangements before 1999 would not be worthwhile, (3) the proposal review process ensured MCOs' compliance with related-party financial disclosure requirements, and (4) requiring MCOs to submit annual cost

¹Under the Medicare+Choice regulations, the full sanction for violation of the reporting requirements of 42 CFR § 422.516 is a corrective action plan or, ultimately, termination of the M+C contract. However, civil monetary penalties and other "intermediate sanctions" also apply to the misrepresentation or falsification of information furnished to the Secretary by an MCO.

statements and eliminate related-party profits would be outside the Medicare+Choice regulations and authority.

In response to CMS's comments:

1. We believe that CMS should evaluate the process of allocating administrative costs claimed in proposals before deciding whether to apply sanctions. In addition, CMS should require United to demonstrate that the administrative costs claimed are fairly distributed.
2. We recommended that CMS assess United's related-party arrangements after, not before, 1999 to ensure compliance with financial disclosure requirements.
3. Although the proposal review process includes an evaluation of administrative costs, the process does not include a review of the related-party financial disclosure documents required to be produced upon audit.
4. We believe that 42 CFR § 422.516 authorizes CMS to request all pertinent data related to the cost of an MCO's operations and to have those costs presented without amounts for related-party profits. Including related-party profits in the proposal can result in overcharges to Medicare beneficiaries and greatly distorts the usefulness of the proposal figures in the evaluation process.

We would appreciate your views and the status of any further action taken or contemplated on our recommendations within the next 60 days. If you have any questions, please contact me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at george.reeb@oig.hhs.gov. Please refer to report number A-06-01-00033 in all correspondence.

Attachments

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF RELATED-PARTY
MANAGEMENT FEES REPORTED BY
FOUR MEDICARE+CHOICE
ORGANIZATIONS IN A CHAIN**



**JULY 2004
A-06-01-00033**

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

Medicare regulations require that Medicare+Choice organizations (MCO) provide the Centers for Medicare & Medicaid Services (CMS) with information on their cost of operations, fiscal soundness, significant business transactions, premiums, and cost sharing. Reporting requirements for significant business transactions, including related-party transactions, are addressed in 42 CFR § 422.516. Information relating to premiums and cost sharing is presented in adjusted community rate proposals (proposals) and addressed in 42 CFR §§ 422.306 and 422.310.

We examined the 1999 financial disclosure reports and the 2001 proposals of four MCOs. Because these MCOs were wholly owned subsidiaries of United HealthCare Services, Inc. (United), the MCOs and United were “related parties.” The MCOs’ 2001 proposals were based on 1999 cost data, including costs reported on their 1999 financial disclosure reports. The proposals contained a total of more than \$100 million in related-party management fees (which are considered administrative costs) paid to United in return for administrative services.

OBJECTIVE

Our objective was to determine whether related-party management fees that the MCOs reported in their 1999 financial disclosure reports and 2001 proposals were based on appropriately allocated, actual costs.

SUMMARY OF FINDINGS

For the more than \$100 million of related-party management fees:

- The MCOs did not show in their financial disclosure reports that the related-party management fees did not exceed the costs that would have been incurred with an unrelated party. The MCOs reported the amounts paid to United but did not disclose the actual costs of services provided by United or the costs that would have been incurred with an unrelated party. Thus, the MCOs were not in compliance with the financial disclosure requirements of 42 CFR § 422.516.
- The MCOs did not have effective procedures to develop and compile data on the cost of their operations. As a result, we could not determine whether the administrative costs reported in the proposals represented a fair distribution of costs. This is required by proposal instructions, and we believe it would be essential in reporting administrative costs to CMS. We could not identify the actual costs of services provided by United because the company did not have a cost accounting system capable of allocating costs by lines of business (such as Medicare, Medicaid, and commercial business). Also, because the MCOs did not base management fees on actual costs, we could not be assured that the fees did not include related-party profits.

RECOMMENDATIONS

We are making the following recommendations, modified to address CMS's comments:

1. CMS should evaluate, based on financial disclosure requirements, the four MCOs' process for developing administrative costs in their proposals and apply administrative sanctions,¹ if appropriate, against these and other United plans. At a minimum, CMS should require United to support the administrative costs allocated to individual plans in the form of management fees.
2. CMS should review financial disclosure reports and proposals for years after 1999 to determine if the MCOs have adequate supporting documentation for management fees.
3. CMS should develop review procedures to ensure that MCOs are in compliance with related-party financial disclosure requirements of 42 CFR § 422.516.
4. CMS should consider requiring home offices of chain MCOs to file an annual cost statement for each plan that shows total actual home office costs and the Medicare share of those costs. Total home office costs should be reconciled to the chain's consolidated financial statements prepared using generally accepted accounting principles (GAAP) to ensure that related-party profits are eliminated and that each plan's Medicare share is reported in its proposal.

CMS COMMENTS

CMS agreed that it needed to reevaluate financial disclosure reports and provide revised instructions, as necessary, to ensure that MCOs are in compliance with related-party financial disclosure requirements. However, CMS believed that (1) levying administrative sanctions or requiring a corrective action plan would not be an effective use of time or resources, (2) attempting to establish an accurate assessment of related-party arrangements before 1999 would not be worthwhile, (3) the proposal review process ensured MCOs' compliance with related-party financial disclosure requirements, and (4) requiring MCOs to submit annual cost statements and eliminate related-party profits would be outside the Medicare+Choice regulations and authority. Appendix B contains the full text of CMS's response to our draft report.

¹Under the Medicare+Choice regulations, the full sanction for violation of the reporting requirements of 42 CFR § 422.516 is a corrective action plan or, ultimately, termination of the M+C contract. However, civil monetary penalties and other "intermediate sanctions" also apply to the misrepresentation or falsification of information furnished to the Secretary by an MCO.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

1. We believe that CMS should evaluate the process of allocating administrative costs claimed in the proposals before deciding whether to pursue sanctions. In addition, CMS should require United to demonstrate that the administrative costs claimed are fairly distributed.
2. We recommended that CMS assess United's related-party arrangements after, not before, 1999 to ensure compliance with financial disclosure requirements.
3. Although the proposal review process includes an evaluation of administrative costs, the process does not include a review of the related-party financial disclosure documents required to be produced upon audit.
4. We believe that 42 CFR § 422.516 authorizes CMS to request all pertinent data related to the cost of an MCO's operations and to have those costs presented without amounts for related-party profits. Including related-party profits in the proposal can result in overcharges to Medicare beneficiaries and greatly distorts the usefulness of the proposal figures in the evaluation process.

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INTRODUCTION

BACKGROUND

Medicare Overview

Under Title XVIII of the Social Security Act, the Medicare program provides health insurance to Americans aged 65 and over, those who have permanent kidney failure, and certain people with disabilities. CMS administers the program.

The Balanced Budget Act of 1997 (Public Law 105-33) established Part C of the Medicare program, which offers Medicare beneficiaries a variety of health delivery models, including MCOs, such as health maintenance organizations; preferred provider organizations; and provider-sponsored organizations. Under the managed care risk-based delivery model, MCOs are responsible for providing all Medicare-covered services, except hospice care, in return for a predetermined capitated payment.

Reporting Requirements

Medicare regulations require that MCOs provide CMS with information relating to (but not limited to) the cost of operations, fiscal soundness, significant business transactions, premiums, and cost sharing. Reporting requirements for significant business transactions, including related-party transactions, are addressed in 42 CFR § 422.516. Information relating to premiums and cost sharing is presented in the proposals and addressed in 42 CFR §§ 422.306 and 422.310.

Medicare+Choice Organizations Reviewed

We reviewed four MCOs that were wholly owned subsidiaries of United, the management company. As such, the MCOs and United were “related parties.” The four MCOs, as well as other MCOs in the nationwide chain, had agreements with United to provide administrative services in return for management fees.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether related-party management fees that the MCOs reported in their 1999 financial disclosure reports and 2001 proposals were based on appropriately allocated, actual costs.

Scope

We selected the four MCOs (listed in Appendix A) based on a review of their 2001 proposals. In total, the proposals included more than \$100 million in related-party management fees. We selected the two MCOs with plans having the highest ratio of administrative costs to direct

medical costs and the two MCOs with plans reporting the highest average Medicare monthly membership. We conducted fieldwork at the four MCOs' offices and at United's office.

We limited our review of the MCOs' internal controls to gaining an understanding of controls over the reporting of related party management fees and the administrative cost allocation methodology.

Methodology

We reviewed the management fees that the MCOs included as administrative costs in their proposals to determine whether the fees represented actual costs incurred.

We also:

- reviewed applicable laws and regulations
- reviewed each MCO's CMS Form 1318 Financial Disclosure Report for 1999, which was the base year for costs reported in the 2001 proposals
- reviewed documentation supporting the administrative costs included in each plan's 2001 proposal
- reviewed documentation relating to each MCO's related-party management agreement
- interviewed MCO officials to obtain an understanding of how the related-party management fees were derived and of each plan's administrative cost allocation methodology
- conducted a limited review of each MCO's cost allocation system to determine whether we could rely on it for determining the Medicare share of actual home office costs

We discussed our findings with United officials to the extent necessary to satisfy ourselves on the validity and accuracy of the facts and our conclusions. We have presented United's oral comments in the relevant sections of the report.

We performed the review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

For the more than \$100 million of related-party management fees:

- The MCOs did not show in their financial disclosure reports that the related-party management fees did not exceed the costs that would have been incurred had their agreements been with an unrelated party. The MCOs reported the amounts paid to United but did not disclose the actual costs of services provided by United or the costs

that would have been incurred with an unrelated party. Thus, the MCOs were not in compliance with the financial disclosure requirements of 42 CFR § 422.516.

- The MCOs did not have effective procedures to develop and compile data on the costs of their operations. As a result, we could not determine whether the administrative costs reported in the proposals represented a fair distribution of costs. This is required by proposal instructions, and we believe it would be essential in reporting administrative costs to CMS. We could not identify the actual costs of services provided by United because the company did not have a cost accounting system capable of allocating costs by lines of business (such as Medicare, Medicaid, and commercial business). Also, because the MCOs did not base management fees on actual costs, we could not be assured that the fees did not include related-party profits.

DISCLOSURE OF RELATED-PARTY TRANSACTIONS

Regulations at 42 CFR § 422.516 require that an MCO disclose significant business transactions between the MCO and a “party in interest” (i.e., a related party). Specifically, 42 CFR § 422.516(b) requires:

With respect to those [related party] transactions-

- (i) A showing that the costs of the transactions listed . . . do not exceed the costs that would be incurred if these transactions were with someone who is not a party in interest; or
- (ii) If they do exceed, a justification that the higher costs are consistent with prudent management and fiscal soundness requirements.

In their 1999 disclosures, the MCOs did not disclose the actual costs of the services provided by United or the costs that would have been incurred under an arrangement with an unrelated party. The MCOs reported only the amounts paid to United.

In conducting our review, we considered the following:

- The MCOs were wholly owned subsidiaries of United. The management fees charged to the MCOs were based on premium revenue rather than enrollment levels or other terms that would more realistically reflect the extent of services actually provided. (See comparison presented in Appendix A.) For three of the four MCOs audited, the management fees were based on a percentage of the premium revenue ranging from 10 to 12 percent.²
- United’s fees were partly based on plan reserve requirements. Plan reserves are funds set aside as a hedge against adverse operating and/or claim experience. The proposal instructions stated that reserves were to be treated as additional revenue, not as part of

²The other MCO’s fees were calculated by (1) adding all service fee revenues and other revenues; (2) subtracting direct medical costs; (3) subtracting 2 percent of service fee revenues, to be retained for reserves and surpluses; and (4) adding an asset management fee equal to 12 percent of investment income.

administrative costs. However, United reduced its fee for one MCO by 2 percent because the MCO needed to increase its reserves as mandated by State regulators. Three years later, after the State reserve requirements had been met, the company increased the fee by 2 percent.

As a result, the four MCOs were not in compliance with the related-party financial disclosure requirements of 42 CFR § 422.516. There was no assurance that the \$100 million in fees paid to United did not exceed the costs that would have been incurred with an unrelated party.

ACTUAL COSTS OF MANAGEMENT SERVICES

Information relating to premiums and cost sharing is presented in the proposals and governed by 42 CFR §§ 422.300 et seq. MCOs are required to complete an annual proposal for each plan and submit the proposal to CMS before the beginning of each contract period. CMS uses the proposal to determine if the estimated capitation to be paid to the MCO exceeds the estimated cost of providing the Medicare-covered services. MCOs must use any excess as prescribed by law, including offering additional benefits, reducing members' premiums, or depositing funds in a stabilization fund administered by CMS. The proposal process was designed to ensure that Medicare beneficiaries are not overcharged for the benefit package offered.

Medicare regulations at 42 CFR § 422.310(a)(5) require MCOs to report actual revenues and expenses derived from an accrual accounting system that uses GAAP. In addition, the proposal instructions state that costs allocated in the proposal must be fairly distributed and that only those administrative costs that bear a significant relationship to the Medicare+Choice plan elected by Medicare enrollees should be included.

The more than \$100 million of related-party management fees reported in the four MCOs' 2001 proposals were not based on appropriately allocated, actual costs. Rather, each MCO reported the total amount it paid to United.

We could not determine the actual costs of services provided under the management agreements because United's administrative cost allocation system was not capable of properly allocating actual costs on a line-of-business basis (Medicare, commercial, etc). Therefore, we could not compare the actual costs of the services provided under the agreements with the management fees charged. United officials stated that it would not be cost beneficial to set up a cost accounting system that allocated costs to lines of business.

Also, because the MCOs did not base management fees on actual costs, we could not be assured that the fees did not include related-party profits. Including related-party profits in a proposal could reduce the funds available to Medicare beneficiaries for additional benefits or reduced premiums.

RECOMMENDATIONS

We are making the following recommendations, modified to address CMS's comments:

- CMS should evaluate, based on financial disclosure requirements, the four MCOs' process for developing administrative costs in their proposals and apply administrative sanctions, if appropriate, against these and other United plans. At a minimum, CMS should require United to support the administrative costs allocated to individual plans in the form of management fees.
- CMS should review financial disclosure reports and proposals for years after 1999 to determine if the MCOs have adequate supporting documentation for management fees.
- CMS should develop review procedures to ensure that MCOs are in compliance with related-party financial disclosure requirements of 42 CFR § 422.516.
- CMS should consider requiring home offices of chain MCOs to file an annual cost statement for each plan that shows total actual home office costs and the Medicare share of those costs. Total home office costs should be reconciled to the chain's consolidated financial statements prepared using GAAP to ensure that related-party profits are eliminated and that each plan's Medicare share is reported in its proposal.

CMS COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In response to CMS's comments on our draft report, we modified our recommendations. Those comments and our response are summarized below. The full text of CMS's comments is included as Appendix B.

Disclosure of Administrative Costs

CMS Comments

CMS agreed that it needed to reevaluate financial disclosure reports and provide revised instructions, as necessary, to ensure that MCOs are in compliance with related-party financial disclosure requirements. However, CMS believed that because the report did not demonstrate that the MCOs paid a materially higher amount to the related party than they would have paid to an unrelated party, levying administrative sanctions or requiring a corrective action plan would not be an effective use of time or resources. CMS will consider our recommendations as part of the audit process and has selected United organizations for audit of the 2003 proposals.

Office of Inspector General Response

As stated in our report and acknowledged by CMS in its comments, United lacked documentation to determine if related-party costs were weighed against what a nonrelated party might have charged. Furthermore, United allocated its administrative costs to Medicare on a percentage-of-revenue basis. We conveyed our concern about using this allocation basis in our July 27, 1998 report entitled “Administrative Costs Submitted by Risk-Based Health Maintenance Organizations on the Adjusted Community Rate Proposals Are Highly Inflated” (A-14-97-00202). In its response to that report, CMS concurred that basing administrative costs on revenue resulted in overstated administrative costs and suggested using a relative cost ratio of actual administrative costs incurred for Medicare beneficiaries in a base year to actual administrative costs incurred for commercial enrollees in the same base year. As our current audit found, United’s methodology did not support an allocation of actual administrative costs due to the limitations of its accounting systems.

There are several methods of allocating and apportioning administrative costs. The proposal instructions state that the cost allocation method must result in a fair distribution of costs. For example, a more equitable method for determining administrative costs would be to allocate the total costs based on enrollment levels (a system used by MCOs that contract with CMS on a cost basis). Using this method, United’s administrative costs allocated to the four MCOs’ Medicare line of business would have been overstated by about \$65 million. (See Appendix A.) Using United’s allocation method, the Medicare line of business was charged 44.6 percent of administrative costs when it comprised only 15.1 percent of enrollment. Therefore, we believe that CMS should evaluate these facts before deciding not to pursue sanctions. In addition, CMS should require United to support the administrative costs allocated to individual plans in the form of management fees.

Review of Related-Party Arrangements After 1999

CMS Comments

CMS stated that attempting to establish an accurate assessment of related-party arrangements before 1999 would not be worthwhile.

Office of Inspector General Response

We did not recommend that CMS assess United’s related-party arrangements before 1999. We did, however, recommend that CMS review these arrangements after 1999 to ensure compliance with financial disclosure requirements. CMS stated that because our review found no accurate systems in place to establish costs, it would not expect to obtain accurate cost data. We would like to emphasize that our audit was limited to 1999 cost information, and we make no assertions regarding United’s cost accounting systems in any other year.

Development of Review Procedures

CMS Comments

In response to our recommendation to develop review procedures to ensure MCOs' compliance with related-party financial disclosure requirements, CMS believed that the proposal review process addressed this recommendation. CMS stated that it would continue to ensure that reviews of an MCO's administrative costs, including related-party transactions, remain a high priority of the audit review process.

Office of Inspector General Response

The proposal review process does include an evaluation of administrative costs. However, the process does not include a review of financial disclosure documents. We believe that CMS should establish such procedures as part of the proposal review process.

Annual Cost Statements

CMS Comments

CMS believed that requiring MCOs to submit annual cost statements and eliminate related-party profits was outside the Medicare+Choice regulations and authority. CMS emphasized that proposals were already reconciled to the audited GAAP financial statements as part of the annual audit process. Moreover, according to CMS, MCOs are allowed to allocate all appropriate costs, including related-party costs.

Office of Inspector General Response

We believe that 42 CFR § 422.516 authorizes CMS to request all pertinent data related to the cost of an MCO's operations and to have those costs presented without amounts for related-party profits. Allowing related-party profits to be included as cost items in the proposal can result in overcharges to Medicare beneficiaries and greatly distorts the usefulness of the proposal figures in the evaluation process. In our opinion, related-party profits are not appropriate costs. Additionally, the appropriateness of costs cannot be determined when the MCO does not provide any documentation for the related-party costs and cannot identify the actual related-party costs.

While we agree that the proposals are already reconciled to the audited GAAP financial statements, related-party profits have not been eliminated from those statements. At a minimum, actual home office costs should be reconciled to the chain's consolidated GAAP financial statements, which should not include related-party profits, before allocating such costs to plans. Upon audit, MCOs should be required to produce an annual home office cost statement showing total costs and the Medicare share of those costs.

APPENDICES

APPENDIX A

UNITED HEALTHCARE
 MANAGEMENT FEE ALLOCATIONS BASED ON REVENUE AND MEMBERSHIP
 (1999 Base Year; 2001 Proposals)

MCO	Contract	Allocation Based on Revenue				Allocation Based on Membership				Excess Medicare Allocation
		Commercial Allocation	Medicare Allocation	Medicaid Allocation	Total	Total Member Months ¹	Medicare Months	Medicare Percentage	Medicare Allocation	
New York	H3379	\$ 15,860,046	\$ 8,293,809	\$ 904,670	\$ 25,058,525	1,096,626	114,210	10.41%	\$ 2,609,763	\$ 5,684,046
Florida	H9011	56,934,589	55,952,610	11,492,544	124,379,743	5,048,257	814,674	16.14%	20,072,065	35,880,545
Illinois	H9045	22,559,147	34,126,275	8,379,071	65,064,493	222,009 ²	47,995	21.62%	14,065,963	20,060,312
Midlands	H2802	9,204,419	5,866,487	4,273,576	19,344,482	749,253	98,718	13.18%	2,548,737	3,317,750
Total		\$104,558,201	\$104,239,181	\$25,049,576	\$233,847,243	7,116,145	1,075,597	15.11%	\$39,296,528	\$64,942,653
	Medicare percentage		44.58%							

¹ Includes all lines of business.

² Based on members, not member months.



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Administrator
Washington, DC 20201

DATE: MAY 2 2008

TO: Janet Rehnquist
Inspector General

FROM: Thomas A. Scully *Tom Scully*
Administrator

SUBJECT: Office of Inspector General (OIG) Draft Report: *Review of Related Party Management Fees Reported by Four Medicare+Choice Organizations (MCOs) in a Chain (A-06-01-00033)*

Thank you for the opportunity to review and comment on the above-referenced draft report. The Centers for Medicare & Medicaid Services (CMS) appreciates the effort that went into this report and the opportunity to review and comment on the issues it raises. We look forward to working with OIG on this and other issues pertinent to MCOs. Our responses to the recommendations are discussed below.

OIG Recommendation

The CMS should evaluate the process followed by United HealthCare, Inc. (United) in developing its administrative costs on the adjusted community rate proposals (ACRPs) based on the financial disclosure requirements and determine whether CMS should apply administrative sanctions against these or other United plans. At a minimum, CMS should require United to develop a corrective action plan that produces actual related party costs.

CMS Response

The CMS agrees that it needs to reevaluate the financial disclosure reports and provide revised instructions, as necessary, to ensure that MCOs are in compliance with the related party financial disclosure requirements of 42 CFR 422.516. Further, CMS agrees that the four MCOs may lack the documentation demonstrating that the related party costs were not weighed against what a nonrelated party may have charged. However, there was no analysis or research provided in the report by OIG demonstrating that United paid a materially higher rate for contracted management services through a related party. Therefore, CMS believes that it would not be an effective use of time or resources to levy administrative sanctions or require a corrective action plan. However, CMS will request pertinent information and review the response to assure that the financial disclosure requirements of 42 CFR 422.516 are met. Additionally, CMS has identified United organizations for the calendar year 2003 ACRP audits and will consider OIG's information and recommendations as part of the audit process.

Page 2 -- Janet Robinson

OIG Recommendation

The CMS should review financial disclosure reports and ACRP submissions for years subsequent to 1999 to determine if United and its subsidiaries submitted adequately supported documentation for administrative cost data.

CMS Response

We agree that United may have not properly disclosed or tracked related party arrangements prior to 1999, but to attempt to try to definitively establish an accurate assessment would prove fruitless. Moreover, the audit report already established that in the 2002 review of the four organizations, there were not accurate cost systems in place to establish costs. Therefore, we see no reason why we could expect to get accurate data prior to 1999.

OIG Recommendation

The CMS should develop review procedures that ensure that MCOs are in compliance with the related party financial disclosure requirements of 42 CFR 422.516.

CMS Response

The CMS provides clear instructions to its contracted auditors by providing audit guidelines via the Uniform Examination Programmed ACRP instructions. Specifically, the contracted auditors are required to attest whether the ACRP was prepared according to generally accepted accounting principles (GAAP) as part of the ACRP audit process and submit a final audit report offering an opinion on worksheet A's management assertion as well as audit "findings" and "observations." Additionally, CMS is in the process of developing an action plan to address findings identified during the respective audits. Finally, CMS will continue to ensure that reviews of an MCO's administration, including related party transactions, remain a high priority of the audit review process.

OIG Recommendation

The CMS should also consider requiring home offices of chain MCOs to file an annual cost statement showing total actual home office costs and the Medicare share of those costs for each plan. Total home office costs should be reconciled to the chain's consolidated GAAP financial statements to ensure that related party profits are eliminated, and each plan's Medicare share would be reported on its ACRP.

CMS Response

We would like to emphasize that the ACRP is already reconciled to the audited GAAP financial statements as part of the annual audit process. Moreover, MCOs are not tied to the cost reimbursement rules and regulations. Thus, to require a chain to submit annual cost statements is

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outside of the Medicare+Choice regulations and authority. Additionally, there is no clear authority to eliminate related party profits under the Medicare+Choice program. Moreover, MCOs are allowed to allocate all appropriate costs, whether the management agreement is with a related party or not. Finally, the MCO can submit a justification for the higher costs, as long as it is prudent to do so (i.e., better quality assurance).