July 26, 2000

Dear State Medicaid Director:

It has come to our attention that some States are using the flexibility in setting the maximum rates that can be paid under the Medicaid program (the so-called "upper payment limits") to pay government-owned facilities at a rate far exceeding their cost of serving Medicaid beneficiaries so that the States can gain Federal Medicaid matching payments without new State contributions. I am writing to say that we intend to address this problem, and to outline our concerns and the process for addressing them.

Background

As you know, under current Federal regulations, States have great flexibility in setting the Medicaid rates that they pay to nursing homes and hospitals. These regulations do establish an overall maximum payment; States may pay facilities a total amount up to the level that Medicare would pay for the same services. However, it appears that some States are:

calculating the maximum amount that, in theory, could be paid to each Medicaid facility (referred to as the "upper payment limit" or "UPL");
adding these amounts together to create excessive payment rates to a few county or municipal facilities;
claiming Federal matching dollars based on these excessive payment rates; and then
directing these county or municipal facilities to transfer large portions of the excessive payments back to the State government.

It appears that many States allow their county-owned providers to keep only a small fraction of the Federal funds (less than five percent) that are used to provide these excessive "reimbursements." The practical outcome is that the States using this financing mechanism actually gain Federal matching payments without any new State financial contribution. This practice is not consistent with the intent of the Medicaid statute that specifies that provider payments must be economic and efficient. If a State requires facilities to refund its own Medicaid contribution, the practice also effectively undermines the requirement that a State share in the funding for its Medicaid program.

Moreover, this practice appears to be creating rapid increases in Federal Medicaid spending, with no commensurate increase in Medicaid coverage, quality, or amount of services provided. There is preliminary evidence that this current practice has contributed to a spike in Federal Medicaid spending. The States' estimates of Federal Medicaid spending for FY 2000 have already increased by $3.4 billion over earlier projections. We believe $1.9 billion of this increase is likely due to the circulation of funds through the UPL loophole. The five-year cost of this growing State practice would be at least $12 billion, and there is an influx of new State proposals. Currently, 17 States have approved plan amendments and another 11 have submitted amendments. This could have the long-term effect of undermining the core mission and the broad-based support for Medicaid, which guarantees critical health services to our most vulnerable populations: low-income children and families, people with disabilities, and the elderly.

The excess Federal Medicaid payments that are shared with State and local governments are put to any number of uses--both health- and non-health-related. It appears some States allow public hospitals to keep a portion of these funds to help pay for uncompensated care. While the Medicaid disproportionate share hospital (DSH) program was created to cover these costs and now accounts for more than $14 billion annually in Medicaid spending, the DSH program has not always met the growing challenge of caring for the uninsured. Some States have, through the UPL arrangement, circumvented the statutory DSH limits--using indirect means to accomplish what the DSH statute does not allow.

Some States are using these payments to pay the statutory State share of Medicaid or of the State Children's Health Insurance Program (SCHIP). While Medicaid and SCHIP are Federal/State partnerships in which each partner pays a share established in statute, the UPL arrangements shift some portion of a State's share to the Federal government. The result is that Federal taxpayers in all States are forced to shoulder more than their fair share for Medicaid and SCHIP in a few States.

Some States are using the UPL arrangement to finance other health programs. This results in Medicaid funding being used for otherwise laudable health care purposes (such as providing community-based services for senior citizens or persons with disabilities) but for people and/or services not eligible for Medicaid coverage.

Other reports suggest that some States have gone so far as to use--or intend to use--the UPL arrangement for non-health purposes. Several States appear to have used it to fill budget gaps. Another State's local newspaper reported that Federal Medicaid funds would be used for State tax cuts or for reducing State debt. One State announced that it intended to use funds generated through the UPL system to pay for education programs. This practice, which is effectively general revenue sharing, is inconsistent with the Medicaid statute, Congressional intent, and Administration policy.

The HHS Office of Inspector General is conducting a review of UPL practices in a number of States and will be reporting on them soon. We are informed that the General Accounting Office may be investigating as well.

Administration Actions

The Administration is committed to supporting health care providers who serve the uninsured and chronically ill and to assuring that they can continue to do so. The President's budget includes more than $100 billion over 10 years to expand health insurance to the uninsured. These funds would reduce the uncompensated care in public hospitals. It also includes a long-term care initiative and Medicare and Medicaid provider payment restoration initiative that explicitly target funding to nursing homes and hospitals, which will also help institutions directly. We have urged the Congress to pass this initiative this year and are developing a new, non-Medicaid program that would target money to public hospitals as part of our efforts to ensure access and quality of health care nationwide .

We are also committed to managing the Medicaid program efficiently under the current law so that it continues to serve Medicaid beneficiaries well and retain the confidence of the nation's taxpayers. The Administration is developing a proposal to ensure that Medicaid payments meet the statutory standard of efficiency and economy. We will publish a Notice of Proposed Rulemaking (NPRM) that modifies the current UPL within the next several weeks. As we work to develop this proposal we will continue to meet with you and representatives of consumers, public hospitals, nursing homes, labor, and others to hear concerns and suggestions. We will also explore the idea of legislation that puts an immediate end to paying States that file a UPL State plan amendment in the intervening period before any regulation takes effect.

Because a number of State health programs rely substantially on funds generated through this UPL loophole, our NPRM will include adequate transition provisions. We will be soliciting comments on our proposed changes to the UPL as well as the transition provisions. We understand that change will be difficult--just as it was in the early 1990's when the Federal/State financing relationship had to be readjusted because of now-illegal State funding mechanisms of donations and taxes. We will specifically solicit comments on proposed transitional periods to address this reliance.

The Medicaid program has been successful over the years in providing vital health care services to millions of low-income Americans. It will continue to be successful only to the extent that it adheres to that mission and ensures that the funds provided are used appropriately and that the program retains its integrity. The program will enjoy public support only if it maintains public trust. I look forward to working with you to preserve that.

Sincerely,

Timothy M.
Westmoreland
Director

cc: All HCFA Regional Administrators All HCFA Associate Regional Administrators for Medicaid and State Operations

Lee Partridge - Director, Health Policy Unit, American Public Human Services Association Joy Wilson - Director, Health Committee, National Conference of State Legislatures Matt Salo - Director, Health Legislation, National Governors' Association

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