DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

OCT 28 2008

TO: Kerry Weems
Acting Administrator
Centers for Medicare & Medicaid Services

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

SUBJECT: Review of Colorado Medicaid Mental Health Capitation and Managed Care Program (A-07-06-04067)

Attached is an advance copy of our final report on the Medicaid Mental Health Capitation and Managed Care Program (the managed care program) in Colorado. We will issue this report to the Colorado Department of Health Care Policy and Financing (the State agency) within 5 business days. We undertook this review of the State agency's supplemental payments to cover mental health services for foster care children in child placement agencies (CPA) in response to a request from the Centers for Medicare & Medicaid Services (CMS).

In 1995, pursuant to State legislation and a waiver approved by CMS under section 1915(b) of the Social Security Act, the State agency implemented the Colorado managed care program. The State agency contracted with mental health assessment and service agencies (MHASA) and paid them a monthly capitation payment to provide all medically necessary mental health services to each Medicaid-eligible enrollee.

According to the State agency, the costs for mental health services for foster care children in CPAs were inadvertently excluded from the initial capitation rates for the managed care contracts. The State agency stated that in 1998, it recognized this oversight and incorporated these costs into the capitation rates.

The State agency claimed Federal financial participation from Medicaid to cover a portion of the costs of these services. However, the State agency asserted that subsequent enrollment increases placed unanticipated stresses on funding for the managed care program. Therefore, beginning in April 2001, the State agency began making supplemental payments (i.e., payments in addition to the monthly capitation payments) to the MHASAs to cover mental health services for foster care children in CPAs.

From April 1, 2001, through November 30, 2004, the State agency made supplemental payments totaling $24,000,947 ($12,227,602 Federal share) to the MHASAs to cover mental health services for foster care children in CPAs. In November 2004, CMS directed the State agency to stop making the payments, and the State agency complied. In November 2005, CMS disallowed

the $487,390 Federal share of the supplemental payments for October and November 2004. CMS requested that we review the remaining $23,026,167 ($11,740,212 Federal share) in supplemental payments made from April 1, 2001, through September 30, 2004.

Our objective was to determine whether the supplemental payments for mental health services provided to foster care children in CPAs for the period April 1, 2001, through September 30, 2004, were consistent with Federal and State requirements.

The supplemental payments that the State agency made for mental health services provided to foster care children in CPAs were not fully consistent with Federal and State requirements. Of the $23,026,167 ($11,740,212 Federal share) in supplemental payments made during our audit period, $3,324,269 (Federal share) was unallowable because, contrary to Federal requirements, the State agency did not obtain CMS's approval of contracts covering the supplemental payments from August 13, 2003, through the end of our audit period (September 30, 2004).

In addition, the State agency did not provide documentation to support its assertion that the remaining $8,415,943 (Federal share) in supplemental payments was removed from the capitation payments. Thus, we are setting aside, for CMS adjudication, the $8,415,943 (Federal share) in potentially duplicate and therefore possibly unallowable supplemental payments.

We recommend that the State agency:

- refund $3,324,269 to the Federal Government for the Federal share of the unauthorized supplemental payments and

- work with CMS to resolve the $8,415,943 (Federal share) in supplemental payments for which the State agency did not provide documentation that the supplemental payments were not already included in the capitation payments.

In written comments on our draft report, the State agency disagreed with our findings and recommendations. After reviewing the State agency's written comments regarding the contracts, we modified our report and removed the finding of unallowable costs related to the failure to comply with State contract provisions. We also modified our report to set aside, rather than question, the $8,415,943 in potentially unallowable supplemental payments. However, our finding that the State agency made $3,324,269 in unallowable supplemental payments covering the period from August 13, 2003, through September 30, 2004, remains unchanged.

If you have any questions or comments about this report, please do not hesitate to call 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 or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-06-04067.

Attachment

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

OCT 31 2008

Report Number: A-07-06-04067

Ms. Joan Henneberry
Executive Director
Colorado Department of Health Care Policy & Financing
1570 Grant Street
Denver, Colorado 80203-1818

Dear Ms. Henneberry:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Colorado Medicaid Mental Health Capitation and Managed Care Program." We will forward a copy of this report to the HHS action official noted on the following page 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 this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, the final report will be posted on the Internet at http://oig.hhs.gov.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Raylene Mason, Audit Manager, at (816) 426-3203 or through e-mail at Raylene.Mason@oig.hhs.gov. Please refer to report number A-07-06-04067 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Jackie Garner, Consortium Administrator
Consortium for Medicaid and Children's Health Operations
Centers for Medicare & Medicaid Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF COLORADO MEDICAID MENTAL HEALTH CAPITATION AND MANAGED CARE PROGRAM

Daniel R. Levinson
Inspector General

October 2008
A-07-06-04067

Office of Inspector General

http://oig.hhs.gov

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Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, Office of Inspector General reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5).

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

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

EXECUTIVE SUMMARY

BACKGROUND

Pursuant to Title XIX of the Social Security Act (the Act), the Medicaid program provides medical assistance to low-income individuals and individuals with disabilities. The Federal and State Governments jointly fund and administer the Medicaid program. At the Federal level, the Centers for Medicare & Medicaid Services (CMS) administers the program. Each State administers its Medicaid program in accordance with a CMS-approved State plan. Although the State has considerable flexibility in designing and operating its Medicaid program, it must comply with applicable Federal requirements. In Colorado, the Colorado Department of Health Care Policy and Financing (the State agency) administers its Medicaid program in accordance with its CMS-approved State plan.

In 1995, pursuant to State legislation and a waiver approved by CMS under section 1915(b) of the Act, the State agency implemented the Colorado Medicaid Mental Health Capitation and Managed Care Program (the managed care program). The State agency contracted with mental health assessment and service agencies (MHASA) and paid them a monthly capitation payment to provide all medically necessary mental health services to each Medicaid-eligible enrollee.

According to the State agency, the costs for mental health services for foster care children in child placement agencies (CPA) were inadvertently excluded from the initial capitation rates for the managed care contracts. The State agency stated that in 1998, it recognized this oversight and incorporated these costs into the capitation rates.

The State agency claimed Federal financial participation from Medicaid to cover a portion of the costs of these services. However, the State agency asserted that subsequent enrollment increases placed unanticipated stresses on funding for the managed care program. Therefore, beginning in April 2001, the State agency began making supplemental payments (i.e., payments in addition to the monthly capitation payments) to the MHASAs to cover mental health services for foster care children in CPAs.

From April 1, 2001, through November 30, 2004, the State agency made supplemental payments totaling $24,000,947 ($12,227,602 Federal share) to the MHASAs to cover mental health services for foster care children in CPAs. In November 2004, CMS directed the State agency to stop making the payments, and the State agency complied. In November 2005, CMS disallowed the $487,390 Federal share of the supplemental payments for October and November 2004. CMS asserted that the payments were not allowable because they were not included in the actuarial certification of the capitation rates under the managed care program and because CMS had not approved contracts covering these payments, as required by Federal regulations. The State agency appealed CMS's disallowance to the U.S. Department of Health and Human Services Departmental Appeals Board (the Board). On May 23, 2007, the Board upheld CMS's disallowance. CMS requested that we review the remaining $23,026,167 ($11,740,212 Federal share) in supplemental payments made from April 1, 2001, through September 30, 2004.

OBJECTIVE

Our objective was to determine whether the supplemental payments for mental health services provided to foster care children in CPAs for the period April 1, 2001, through September 30, 2004, were consistent with Federal and State requirements.

SUMMARY OF FINDINGS

The supplemental payments that the State agency made for mental health services provided to foster care children in CPAs were not fully consistent with Federal and State requirements. Of the $23,026,167 ($11,740,212 Federal share) in supplemental payments made during our audit period, $3,324,269 (Federal share) was unallowable because, contrary to Federal requirements, the State agency did not obtain CMS's approval of contracts covering the supplemental payments from August 13, 2003, through the end of our audit period (September 30, 2004).

In addition, the State agency did not provide documentation to support its assertion that the remaining $8,415,943 (Federal share) in supplemental payments was removed from the capitation payments. Thus, we are setting aside, for CMS adjudication, the $8,415,943 (Federal share) in potentially duplicate and therefore possibly unallowable supplemental payments.

RECOMMENDATIONS

We recommend that the State agency:

- refund $3,324,269 to the Federal Government for the Federal share of the unauthorized supplemental payments and

- work with CMS to resolve the $8,415,943 (Federal share) in supplemental payments for which the State agency did not provide documentation that the supplemental payments were not already included in the capitation payments.

STATE AGENCY COMMENTS

In written comments on our draft report, the State agency disagreed with our findings and recommendations. The State agency said that it amended its contract verbally, as evidenced by its conduct and the conduct of its contractors. Moreover, the State agency said that it was in the process of submitting revised contracts to the State Controller for approval.

The State agency's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing the State agency's written comments regarding the contracts, we modified our report and removed the finding of unallowable costs related to the failure to comply with State contract provisions. We also modified our report to set aside, rather than question, the $8,415,943 in potentially unallowable supplemental payments for the period April 1, 2001,

through August 12, 2003, because the State agency did not provide documentation to support its assertion that the supplemental payments were not already included in the capitation payments. Our finding that the State agency made $3,324,269 in unallowable supplemental payments covering the period from August 13, 2003, through September 30, 2004, remains unchanged.

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INTRODUCTION

BACKGROUND

Medicaid Program

Pursuant to Title XIX of the Social Security Act (the Act), the Medicaid program provides medical assistance to low-income individuals and individuals with disabilities. The Federal and State Governments jointly fund and administer the Medicaid program. At the Federal level, the Centers for Medicare & Medicaid Services (CMS) administers the program. Each State administers its Medicaid program in accordance with a CMS-approved State plan. Although the State has considerable flexibility in designing and operating its Medicaid program, it must comply with applicable Federal requirements. Under section 1915(b) of the Act, the State may request that CMS grant waivers of certain requirements of the Act.[1]

In Colorado, the Department of Health Care Policy and Financing (the State agency) administers the Medicaid program.[2] The Federal Government pays its share of the State's Medicaid expenditures according to a formula that yields the Federal medical assistance percentage (FMAP). During our audit period, the FMAP ranged from 50 to 52.95 percent.

Colorado Mental Health Services Program

Before 1995, Medicaid beneficiaries in Colorado received mental health services through either a fee-for-service system or health maintenance organizations. To achieve cost savings, the Colorado General Assembly authorized the State agency to provide comprehensive mental health services to Medicaid beneficiaries through a capitated managed care program. Initially set up on a pilot basis, the program was expanded statewide in 1995.

To implement the mental health managed care program, the State agency requested a section 1915(b) waiver from CMS. CMS approved the waiver, allowing the State agency to implement the Colorado Medicaid Mental Health Capitation and Managed Care Program (the managed care program). Under the managed care program, the State agency contracts with several mental health assessment and service agencies (MHASA), which operate in specific areas of the State.[3] The State agency prepays a monthly capitation payment to each MHASA for each enrolled Medicaid beneficiary. In return, the MHASA supplies all medically necessary mental health services to the enrollee. The State agency pays the MHASA regardless of whether the enrollee receives services during the period of coverage.

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[1]Section 1902 of the Act mandates specific requirements that States must meet in administering their Medicaid programs, including (but not limited to) a Medicaid beneficiary's right to choose a medical services provider. Under section 1915(b), CMS may grant the States waivers of certain requirements of section 1902, including the choice of providers.

[2]The Colorado Department of Human Services administered the Medicaid program until April 2004, when responsibility transferred to the Department of Health Care Policy and Financing. In this report, the term "State agency" refers to either entity, depending on the period under discussion.

[3]In 2004, MHASAs became known as behavioral health organizations.

Supplemental Payments Covering Mental Health Services for Foster Care Children in Child Placement Agencies

According to the State agency, the costs for mental health services for foster care children in child placement agencies (CPA) were inadvertently excluded from the initial capitation rates for the managed care contracts.[4] The State agency stated that in 1998, it recognized this oversight and incorporated these costs into the capitation rates.

The State agency claimed Federal financial participation from Medicaid to cover a portion of the costs of these services. However, the State agency asserted that subsequent enrollment increases placed unanticipated stresses on the funding for the managed care program. Therefore, beginning in April 2001, the State agency began making supplemental payments (i.e., payments in addition to the monthly capitation payments) to the MHASAs to cover mental health services for foster care children in CPAs. From April 1, 2001, through November 30, 2004, the State agency made supplemental payments totaling $24,000,947 ($12,227,602 Federal share) to the MHASAs.

Actions Leading to Disallowance of Supplemental Payments

In April 2004, CMS Region VIII reviewed the State agency's payments to the MHASAs, including the supplemental payments covering mental health services for foster care children in CPAs. In November 2004, CMS directed the State agency to stop making the payments. In November 2005, CMS disallowed the $487,390 Federal share of the supplemental payments for October and November 2004. CMS asserted that the payments were not allowable because they were not included in the actuarial certification of the capitation rates under the managed care program and because CMS had not approved contracts covering these payments.[5]

In Colorado's statewide single audit for the State fiscal year ending June 30, 2004, the Colorado State Auditor's office reported that it could not substantiate that the amount paid to a MHASA for mental health services for foster care children in CPAs was appropriate and allowable under Medicaid requirements. The State agency was unable to provide the State Auditor's office with documentation for the methodology it used to determine the amount paid to this MHASA and agreed with the audit finding.

The State agency complied with CMS's directive to stop making the supplemental payments but appealed the disallowance to the U.S. Department of Health and Human Services Departmental Appeals Board (the Board). On May 23, 2007, the Board upheld CMS's disallowance. CMS requested that we review the remaining $23,026,167 ($11,740,212 Federal share) in supplemental payments made from April 1, 2001, through September 30, 2004**.**

[4]A CPA is a person or an organization that places or arranges for placement of any child under the age of 16 into foster care or adoption.

[5]Actuarial certification and contract approval are required by Federal regulations at 42 CFR § 438.6(c)(2) and 42 CFR § 438.6(a), respectively.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether the supplemental payments for mental health services provided to foster care children in CPAs for the period April 1, 2001, through September 30, 2004, were consistent with Federal and State requirements.

Scope

Our audit covered the period from April 1, 2001, through September 30, 2004. We reviewed the $23,026,167 ($11,740,212 Federal share) in supplemental payments that the State agency made to MHASAs to cover mental health services provided to foster care children in CPAs.

We limited our internal control review to the procedures that the State agency followed in administering its managed care program. We also considered the analysis of internal controls included in the 2004 State Auditor's report. We did not review the State agency's controls over its computerized payment system.

We conducted fieldwork at the State agency in Denver, Colorado.

Methodology

To accomplish our objective, we:

- reviewed Federal and State laws and regulations, program guidance, contractual documents, the State plan, and the section 1915(b) waiver;

- reviewed the Board's May 2007 decision, as well as documentation that CMS and the State agency filed with the Board;

- reviewed the 2004 State Auditor's report, which included a finding pertaining to supplemental payments covering mental health services for foster care children in CPAs;

- reviewed records and interviewed personnel from the State agency to (a) verify that mental health services for foster care children in CPAs were paid by a supplemental payment separate from the CMS-approved capitation payment and (b) determine whether the State agency had removed costs associated with mental health services for foster care children in CPAs from the capitation rates;

- interviewed CMS regional personnel and obtained documentation pertaining to both the approved capitation payment method for mental health services and the supplemental payments;

- analyzed data from the State Medicaid Management Information System to identify the supplemental payments made to the MHASAs for mental health services for foster care children in CPAs;

- reconciled the State agency's supplemental payment amounts to the Federal Medicaid Statistical Information System and to State agency financial transaction requests for payments to the MHASAs; and

- reconciled the State agency's supplemental payments to the MHASAs' documentation.

We calculated the Federal share of the supplemental payments using the FMAP applicable to each timeframe within our audit period (ranging from 50 to 52.95 percent).

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

FINDINGS AND RECOMMENDATIONS

The supplemental payments that the State agency made for mental health services provided to foster care children in CPAs were not fully consistent with Federal and State requirements. Of the $23,026,167 ($11,740,212 Federal share) in supplemental payments made during our audit period, $3,324,269 (Federal share) was unallowable because, contrary to Federal requirements, the State agency did not obtain CMS's approval of contracts covering the supplemental payments from August 13, 2003, through the end of our audit period (September 30, 2004).

In addition, the State agency did not provide documentation to support its assertion that the remaining $8,415,943 (Federal share) in supplemental payments was removed from the capitation payments. Thus, we are setting aside, for CMS adjudication, the $8,415,943 (Federal share) in potentially duplicate and therefore possibly unallowable supplemental payments.

These errors occurred because the State agency did not follow Federal and State requirements in the administration of its Medicaid managed care program.

UNALLOWABLE SUPPLEMENTAL PAYMENTS

Federal Regulations and Departmental Appeals Board Ruling

Pursuant to Federal regulations (42 CFR § 438.6(a)), which were implemented on August 13, 2003, the CMS regional office must "review and approve all . . . PIHP [prepaid inpatient health plan] . . . contracts . . . ." [6]

The State agency appealed CMS's disallowance of the October and November 2004 supplemental payments to the Board. On May 23, 2007, the Board, in Decision No. 2085, upheld CMS's disallowance of the supplemental payments for October and November 2004

[6]When these Federal regulations were promulgated on August 13, 2002, States were initially given until June 16, 2003, to fully comply with the provisions. This effective date was subsequently changed to August 13, 2003.

($487,390 Federal share). The Board ruled that the State agency had violated 42 CFR § 438.6 by failing to submit contracts for CMS's approval of the supplemental payments. The Board concluded "that these supplemental costs must be disallowed. CMS has never reviewed and approved a contract that covers these costs pursuant to the regulations and consequently has never found that these costs are necessary for the proper and efficient administration of the State plan as the statute and regulations require."[7]

State Payments Made Without Centers for Medicare & Medicaid Services Approval

The State agency did not obtain CMS's approval of the contracts covering the supplemental payments as it was required to do, effective August 13, 2003. Submission of contracts for CMS approval would have provided timely information that the supplemental payments were funding mental health services for Medicaid beneficiaries who were already eligible for such services under the managed care program. Because the State agency did not submit any contracts addressing supplemental payments for CMS approval, CMS was not able to determine whether the supplemental payments were "necessary for the proper and efficient administration of the State plan as the statute and regulations require." Consistent with the Board's decision, none of the payments on or after August 13, 2003, were eligible for Federal financial participation.

From April 1, 2001, through September 30, 2004, the State agency made a total of $23,026,167 ($11,740,212 Federal share) in supplemental payments. Of this amount, $3,324,269 (Federal share), which was paid beginning on August 13, 2003, was unallowable.

POTENTIALLY UNALLOWABLE SUPPLEMENTAL PAYMENTS

Approved Federal Waiver and Federal Regulations

As specified in the CMS-approved section 1915(b) waiver, the State agency entered into contracts with the MHASAs to administer the mental health managed care program. The contracts, which CMS reviewed as part of the waiver approval process, provided for monthly prepaid capitation payments to the contracting MHASAs consistent with the section 1915(b) waiver. The contracts required the contracting MHASAs to provide all medically necessary mental health services to all Medicaid-eligible recipients, including foster care children.

The CMS "State Medicaid Manual," section 2497.1, states that "Expenditures are allowable only to the extent that, when a claim is filed, you have adequate supporting documentation in readily reviewable form to assure that all applicable Federal requirements have been met." Office of Management and Budget (OMB) Circular A-87, section C(1)(a), states that to be allowable under Federal awards, costs must "Be necessary and reasonable for proper and efficient performance and administration of Federal awards." Additionally, section C(1)(j), provides that costs must be adequately documented.

[7] Colorado Department of Health Care Policy and Financing, DAB No. 2085 (May 23, 2007). The Board is referring to 42 CFR § 438.1 (implementing section 1902(a)(4) of the Social Security Act).

Potential Duplication of Payments

The State agency did not provide documentation that the $8,415,943 (Federal share) in supplemental payments was removed from the capitation payments.

The State agency acknowledged that its contracts with the MHASAs required the MHASAs to provide all mental health services to all Medicaid-eligible recipients. However, the State agency said that the costs of providing these mental health services to foster care children in CPAs were inadvertently excluded from the capitation rates when the managed care program began in 1995. According to the State agency, in 1998 it recognized this oversight and incorporated these costs into the managed care capitation rates.

The State agency claimed Federal financial participation from Medicaid to cover a portion of the costs of these services. However, the State agency asserted that subsequent enrollment increases placed unanticipated stresses on the funding for the managed care program. The State agency said that therefore, beginning in April 2001, it removed the costs associated with the mental health services for foster care children in CPAs from the capitation rates and began paying for those services through a series of supplemental payments to the MHASAs.

During our audit fieldwork, we requested that the State agency provide documentation that the costs associated with the mental health services provided to foster care children in CPAs were removed from the capitation rates. However, the State agency did not provide such documentation. As a result, it could not support its assertion that the costs of providing mental health services to foster care children in CPAs were reimbursed only once and therefore that all Federal requirements had been met. In the absence of this documentation, we, in turn, could not determine whether these costs were necessary and reasonable for proper and efficient performance and administration of the Federal award.

FEDERAL AND STATE REQUIREMENTS NOT FOLLOWED

These errors occurred because the State agency did not follow Federal and State requirements in the administration of its Medicaid managed care program. From April 1, 2001, through September 30, 2004, the State agency made unallowable and potentially unallowable supplemental payments totaling $23,026,167 ($11,740,212 Federal share) to MHASAs. (See Appendix A.)

RECOMMENDATIONS

We recommend that the State agency:

- refund $3,324,269 to the Federal Government for the Federal share of the unauthorized supplemental payments and

- work with CMS to resolve the $8,415,943 (Federal share) in supplemental payments for which the State agency did not provide documentation that the supplemental payments were not already included in the capitation payments.

STATE AGENCY COMMENTS

In written comments on our draft report, the State agency disagreed with our findings and recommendations.

The State agency said that it amended its contract verbally, as evidenced by its conduct and the conduct of its contractors. Specifically, the State agency said that "[g]eneral principles of contract law do not require that contracts – or amendments to contracts – be made in writing" and "contracts [can be] manifested by conduct." The State agency said that contemporaneous documentation exists which "memorialize[s] the parties' intent to modify the payment [terms]" and added that the "MHASAs' continued provision of services reflects their assent to the change of terms." Moreover, the State agency said that it was in the process of submitting revised contracts to the State Controller for approval.

The State agency also said that it removed the county-funded amount covering mental health services provided to foster care children in CPAs from the capitation rate and replaced it with a fixed supplemental payment. In addition, the State agency said that if the supplemental payment was disallowed, it would present the revised actuarially certified capitation rate to CMS with retroactive contract amendments.

The State agency's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing the State agency's written comments regarding the contracts, we modified our report and removed the finding of unallowable costs related to the failure to comply with State contract provisions. We also modified our report to set aside, rather than question, the $8,415,943 in potentially unallowable supplemental payments for the period April 1, 2001, through August 12, 2003, because the State agency did not provide documentation to support its assertion that the supplemental payments were not already included in the capitation payments. Our finding that the State agency made $3,324,269 in unallowable supplemental payments covering the period from August 13, 2003, through September 30, 2004, remains unchanged. This finding is consistent with the Board's decision that the supplemental payments for October and November 2004 were ineligible for Federal financial participation because CMS had not approved the contract.

During our audit fieldwork, we requested that the State agency provide documentation that would support its assertion that it had removed the costs associated with the mental health services provided to foster care children in CPAs from the capitation rates when it established the fixed supplemental payments. After receiving the State agency's written comments on our draft report, we again requested that documentation. However, none of the information we subsequently received from the State agency demonstrated that the costs were removed from the capitation rates. As a result, the State could not support its assertion that the costs of providing mental health services to foster care children in CPAs were reimbursed only once and therefore that all Federal requirements had been met. Thus, we set aside the $8,415,943 in potentially unallowable supplemental payments for the period April 1, 2001, through August 12, 2003, for CMS adjudication.

APPENDIXES

APPENDIX A

COLORADO SUPPLEMENTAL PAYMENTS

POTENTIALLY UNALLOWABLE SUPPLEMENTAL PAYMENTS APRIL 1, 2001, THROUGH AUGUST 12, 2003

Period	FMAP[1]	Supplemental Payments	
		Total	Federal Share
04/01/2001-06/30/2001	50.00%	$1,588,105	$794,053
07/01/2001-09/30/2001	50.00%	1,788,206	894,103
10/01/2001-12/31/2001	50.00%	1,788,207	894,104
01/01/2002-03/31/2002	50.00%	1,788,207	894,104
04/01/2002-06/30/2002	50.00%	1,788,207	894,104
07/01/2002-09/30/2002	50.00%	1,809,558	904,779
10/01/2002-12/31/2002	50.00%	1,752,968	876,484
01/01/2003-03/31/2003	50.00%	1,561,262	780,631
04/01/2003-06/30/2003	52.95%	1,712,373	906,702
07/01/2003-08/12/2003	52.95%	1,089,479	576,879
Total Questioned		**$16,666,572**	**$8,415,943**

UNALLOWABLE SUPPLEMENTAL PAYMENTS AUGUST 13, 2003, THROUGH SEPTEMBER 30, 2004

Period	FMAP[1]	Supplemental Payments[2]	
		Total	Federal Share
08/13/2003-09/30/2003	52.95%	$ 464,748	$ 246,084
10/01/2003-12/31/2003	52.95%	1,394,226	738,243
01/01/2004-03/31/2004	52.95%	1,394,226	738,243
04/01/2004-06/30/2004	52.95%	1,644,226	870,618
07/01/2004-09/30/2004	50.00%	1,462,170	731,085
Total Questioned		**$6,359,595**	**$3,324,269**

[1]FMAP = Federal medical assistance percentage.

[2]Does not add to total because of rounding.

COLORADO DEPARTMENT OF HEALTH CARE POLICY & FINANCING

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Bill Ritter, Jr., Governor • Joan Henneberry, Executive Director

March 28, 2008

Patrick J. Cogley, Regional Inspector General for Audit Services
Office of Inspector General, Offices of Audit Services
Region VII Department of Health and Human Services
601 E. 12th St., Room 284A
Kansas City, Missouri 64106

Re: Draft Review of Colorado Medicaid Mental Health Capitation and Managed Care Program, Report Number A-07-06-04067

Dear Mr. Cogley:

You have offered the opportunity for the Department of Health Care Policy and Financing ("Department") to respond to the Draft Review of Colorado Medicaid Mental Health Capitation and Managed Care Program, Report Number A-07-06-04067 ("Draft Audit Findings"), which reviewed whether supplemental payments for mental health services provided to foster care children in Child Placement Agencies ("CPA") for the period of April 1, 2001 through September 30, 2004 were consistent with Federal and State requirements. The Draft Audit Findings concluded that none of the $11,740,212 in Federal share of supplemental payments complied with Federal and State requirements because:

- The State agency did not obtain CMS's approval of contracts covering the supplemental payments, as required from August 13, 2003, through the end of the audit period; and
- The supplemental payments did not comply with the State agency's contract provisions for modifications.

Draft Audit Findings at 4.

The following represents the Department's response.

A. The Department disagrees with the Audit's conclusion that payments during the period of April 1, 2001 through August 13, 2003 were unallowable because they failed to comply with State contract provisions

The Draft Audit Findings concluded that the federal share payments between April 1, 2001 and August 13, 2003 were not allowable because the Department failed to comply with the term of the contracts with the Mental Health Assessment and Service Agencies ("MHASAs") that required that contract modifications be agreed to in writing in an amendment to the contract. Draft Audit Findings at 5.

In order to form a contract, evidence must exist which shows that the parties agreed upon all essential terms. *I.M.A., Inc. v. Rocky Mountain Airways, Inc.*, 713 P.2d 882, 888 (Colo. 1986). When the agreement is manifested by written or oral words, the contract is an express contract. *Fair v. Red Lion Inn*, 920 P.2d 820, 825 (Colo. 1995). A contract which is manifested by conduct is a contract implied-in-fact. *Id.* Parties can modify or amend a previously-existing contract. *Id.*; *see also Western Air Lines, Inc. v. Hollenbeck*, 235 P.2d 792, 796 (Colo. 1951).

In 2001, the Department and the MHASAs collectively modified the payment terms within the contracts. The Department of Human Services, on behalf of the Department, changed its method of payment to the MHASAs by removing that portion of the capitated rate provided by the participating counties for CPA services. In doing so, the Department agreed to make that portion of the county payments as a supplemental payment. Under general principles of contract law, contracts can be established either in writing or by oral words.

During the audit review, the Department provided to the auditor copies of certain transmittal letters dated June 14, 2001 through May 11, 2004 to the Department's fiscal agent, Consultec, Inc. (later known as ACS, Inc.), which requested monthly payments be made to the MHASAs. The early transmittal letters (June 2001 through September 2002) each memorialize all parties' agreement to remove the CPA payments from the capitated rate and to make them as supplemental payments:

> "All parties have agreed that, in order to balance to funding, flat rate payments need to be added onto the regular MHASA PMPM payments on a monthly basis, rather than using the number of Foster Care eligibles as a proxy. It is our intent to process similar financial transactions on a monthly basis, as I discussed with you earlier on the phone."

As the above-quoted letter from the Office of Health and Rehabilitation, Department of Human Services to the Account Manager, Consultec, Inc. (June 13, 2001, forwarded to Contsultec, Inc. for processing by the Department of Health Care Policy & Financing on June 14, 2001) demonstrates, the MHASAs clearly agreed to the change in payment methodology, because they continued to provide services pursuant to the contracts and received payment consistently with the agreed-upon supplemental payment. Further the Office of Health and Rehabilitation staff within the Department of Human Services sent multiple email communications to the MHASAs in February 2001 that memorialize the change in payment methodology.

General principles of contract law do not require that contracts – or amendments to contracts – be made in writing. Further, general contract law principles allow contracts to be manifested by conduct. Here, the parties did manifest intent to modify the written contracts to reduce the capitated rate, in exchange for a lower capitated rate combined with a supplemental payment. The contemporaneous email communication to the MHASAs and the transmittal letters to Consultec, Inc. (later ACS, Inc.) memorialize the parties' intent to modify the payment structure to the MHASAs, and the MHASAs' continued provision of services reflects their assent to the change of terms.

The Draft Audit Findings take issue with payments made from April 1, 2001 through August 13, 2003 because the contract amendment was not in writing, in accordance with State contracting provisions. Although general principles of contract law do not require that a contract be in writing, the Department recognizes that the amendment was not submitted to the State Controller for approval. The Department is in the process of memorializing the contract amendments with the MHASAs through Memoranda of Contractual Agreement, in order to satisfy any remaining State contracting obligations.

B. The Department disagrees with the Audit's conclusion that payments during the period of August 13, 2003 through September 30, 2004 were unallowable because they failed to comply with State contract Provisions and because they did not meet the requirements of 42 C.F.R. § 438.6

1. The lack of a formalized written contract amendment should not serve as a basis for determining the payment is not allowable

For the reasons stated in Section A, above, it is the Department's position that there was an agreement between the Department and the MHASAs to modify their contracts, either as an express or implied-in-fact amendment. The Department is in the process of reducing the contract amendments to writing for review and approval by the State Controller. As a result, payments should not be determined to be not allowable on that basis.

2. The Department is in the process of preparing contracts for CMS review and approval

CMS approved the Department's waiver for the period of May 5, 2003 through May 4, 2005 in May 2003. At that time, 42 C.F.R. § 438.6 was not yet in effect. 42 C.F.R. § 438.6(c), which prohibits supplemental payments without CMS' approval, was not in effect until August 13, 2003. *See* 67 Fed. Reg. 40989-01 (June 14, 2002), as modified by 67 Fed. Reg. 42609-01 (June 24, 2002). As a result, for the periods prior to the waiver period at issue, including the time during which the Department prepared its waiver submission at issue here, 42 C.F.R. § 438.6 did not prohibit supplemental payments. Thus, prior to August 2003, the Department's supplemental payments to providers did not contradict CMS' requirements for capitation contracts, because the prohibition against supplemental payments did not exist.

The Department established the supplemental payments prior to the regulatory change that prohibited such practices. The Department did not intend, nor did it establish, any sort of unauthorized supplemental payment system to circumvent federal regulations. Rather, at worst, the Department's existing payment structure merely failed to conform to the regulatory requirements implemented by 42 C.F.R. § 438.6 in August 2003.

The Draft Audit Findings also concluded that the federal share paid after August 13, 2003 was not allowable because the Department did not obtain CMS' approval of the contracts for the 13.5 month period of August 13, 2003 through September 30, 2004, which represented a federal share of approximately $3,489,670.50.

Contrary to the concerns inherent to the issues raised by the Draft Audit Findings, in 2001 the Department removed the county-funded amount from the capitated rate to avoid, rather than increase, additional spending. The removal of the county-funded amount from the capitated rate, which was replaced with a fixed supplemental payment, was intended to cap and control program expenses – including the associated Federal share – rather than give rise to the expenditure of additional moneys. Under the single capitated rate, the county-funded share was allocated as a portion of the per-member per-month ("PMPM") capitated rate. For each additional enrolled member, the MHASA receive the additional PMPM payment. As enrollment figures swelled, the fixed amount of county funding – together with the associated FFP – increased to the point of over-spending of county-funded amounts. To halt the over-expenditure, the Department removed the county-funded portion of the PMPM capitated rate and returned the county-funded portion to a fixed rate. The net result of the change in payment methodology resulted in a decrease in overall spending – both from the county and the Federal shares.

Upon its implementation in August 2003, 42 C.F.R. § 438.6 required CMS approval of contracts, prohibited certain supplemental payments, and required that capitated rates be certified as actuarially sound.

There is no dispute that the MHASAs provided services which are approved by CMS for federal financial participation ("FFP"). CMS has stated that FFP may be available for supplemental payments where those payments were included within a capitated amount and certified as actuarially sound. Likewise, 42 C.F.R. § 438.6 does not prohibit retroactive recalculation of rates and actuarial certification. Furthermore, retroactive rate adjustment is allowed in various contexts. *See, e.g., Country View Care Center, Inc. v. Colorado Dep't of Soc. Servs.*, 703 P.2d 1334, 1334 (Colo. App. 1985).

Upon the removal in 2001 of that portion of the capitated rate supplied by the counties, paid instead through the supplemental fixed payment, the reduced amount remaining in the capitated rate no longer was adequate to account for the costs of CPA services. As a result, for the period in question, if the supplemental fixed payment is disallowed, it would be actuarially necessary to retroactively increase capitation payments to appropriately consider the cost of the CPA services. The increased capitated rate must be submitted for actuarial certification so that the Department can present the actuarially-certified capitated rate to CMS with retroactive contract amendments.

The Department has already begun the process of obtaining actuarial review of rates to include CPA services. The Department has obtained preliminary actuarial certification for Fiscal Year 2006 capitation rates, which would replace July 1, 2005 through June 30, 2006 capitation rates previously made without CPA services included. Based on the audit findings, the Department is starting to recalculate the capitation rate impact of the elimination of the supplemental payment

for periods prior to that, including the period under question in the audit. The Department plans to discuss with CMS this rate calculation and anticipates having this calculation actuarially certified to obtain CMS approval.

Although the Department disagrees with the audit conclusion that it did not modify the contracts with the MHASAs, the Department is in the process of memorializing those contract amendments for the period prior to August 2003. For the period from August 2003 to September 2004, the Department is in the process of making contract amendments and obtaining revised certification letters to correct the rate calculation, and will submit them to CMS for approval. Once these measures have been taken, the Department should be in compliance, and there should be no need to refund any funds to CMS.

Thank you for your time and commitment to helping Colorado's Medicaid program most effectively serve its clients.

If you have any questions or concerns, please contact Laurel Karabatsos at laurel.karabatsos@state.co.us

Sincerely,

Joan Henneberry
Executive Director

JH/ak

Ashley Klein, Attorney General's Office
Sandeep Wadhwa, MD, Medical & CHP+ Administration Director
Laurel Karabatsos, Benefits Division Director
John Bartholomew, Budget Division Director
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