



MAR 20 2006

Office of Audit Services
Region IX
50 United Nations Plaza, Room 171
San Francisco, CA 94102

Report Number: A-09-05-00077

Mr. Howard Matsukane
Director
PacifiCare Health Systems, Inc.
3100 Lake Center Drive, Mail Stop LC03-143
Santa Ana, California 92704

Dear Mr. Matsukane:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of PacifiCare of Colorado's Modifications to Its 2004 Adjusted Community Rate Proposal Under the Medicare Prescription Drug, Improvement, and Modernization Act." A copy of this report will be forwarded 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 the HHS action 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.

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Please refer to report number A-09-05-00077 in all correspondence.

Sincerely,

Lori A. Ahlstrand
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Cynthia E. Moreno
Director, Medicare Plan Accountability Group
Centers for Medicare & Medicaid Services
Department of Health and Human Services
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Department of Health and Human Services
OFFICE OF
INSPECTOR GENERAL

REVIEW OF PACIFICARE OF
COLORADO'S MODIFICATIONS TO
ITS 2004 ADJUSTED COMMUNITY
RATE PROPOSAL UNDER THE
MEDICARE PRESCRIPTION DRUG,
IMPROVEMENT, AND
MODERNIZATION ACT



Daniel R. Levinson
Inspector General

MARCH 2006
A-09-05-00077

Office of Inspector General

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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

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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

Under Part C of the Medicare program, Medicare Advantage organizations (MAOs) are responsible for providing all Medicare-covered services, except hospice care, in return for a predetermined capitated payment. The Medicare Prescription Drug, Improvement, and Modernization Act (MMA) of 2003 provided increased capitation payments to MAOs effective March 2004.

For plans with increased capitation payments, the MMA required MAOs to submit revised adjusted community rate proposals (proposals) that identified how they would use the increased payments during contract year 2004. Section 211 of the MMA allows MAOs to use the MMA payment increases to:

- reduce beneficiary premiums,
- reduce beneficiary cost sharing,
- enhance benefits,
- contribute to a benefit stabilization fund, or
- stabilize or enhance beneficiary access to providers.

Additionally, Federal regulations (42 CFR § 422.310(c)(5)) require that MAO proposal rates be supported.

PacifiCare of Colorado (PacifiCare) submitted revised proposals for contract year 2004 that reflected an increase in Medicare capitation payments provided by the MMA legislation of about \$5.1 million for three of its plans. PacifiCare proposed to use the additional funding to reduce beneficiary premiums, enhance benefits, and stabilize or enhance beneficiary access to providers.

OBJECTIVE

Our objective was to determine whether PacifiCare's use of its MMA payment increase was adequately supported and allowable pursuant to the MMA.

SUMMARY OF FINDINGS

Of the \$5,148,375 capitation payment increase in PacifiCare's revised proposals, \$5,013,375 was adequately supported and allowable pursuant to the MMA. The remaining \$135,000 was adequately supported; however, PacifiCare did not use these funds to enhance access to providers under plan 002 as stated in its revised proposal. Instead, PacifiCare used the funds to enhance access to providers by opening a new medical facility serving beneficiaries enrolled in plans 006 and 007. Since plan 002 enrollees did not benefit from the \$135,000 of increased capitation payments, PacifiCare's use of the payments was unallowable.

RECOMMENDATION

We recommend that PacifiCare refund to the Federal Government \$135,000, representing the portion of the MMA payment increase that was not used pursuant to the MMA.

PACIFICARE'S COMMENTS

In its comments on the draft report, PacifiCare generally agreed with the facts presented. However, PacifiCare disagreed with our finding that it did not enhance or stabilize access to providers in plan 002 by not adding a medical practice in the Colorado Springs area. PacifiCare stated that enhanced or stabilized access to providers was not solely dependent upon adding a new medical practice. Further, PacifiCare stated that the MMA funding to establish a new medical practice allowed PacifiCare to work with an existing provider group to strengthen the provider network, and therefore, enhance or stabilize members' access. Finally, PacifiCare stated that the vast majority of the MMA funding was used precisely as indicated in its revised proposals and that the \$135,000 we recommended for refund was used in support of other plans covered by the same contract.

The full text of PacifiCare's comments is included as an appendix to this report. Where appropriate, we made changes in the body of the final report to reflect PacifiCare's comments.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The Centers for Medicare & Medicaid Services (CMS) approved PacifiCare's revised proposal to use \$135,000 to enhance or stabilize access to providers by adding a new medical practice to serve beneficiaries in plan 002. However, PacifiCare did not establish a medical practice in the Colorado Springs area as stated in its revised proposal. In addition, PacifiCare did not provide us with evidence indicating how it strengthened the provider network under plan 002 to enhance or stabilize members' access.

We agree that PacifiCare spent \$135,000 of the MMA payment increase on other plans covered by the same contract. However, CMS approved the \$135,000 increase to be used for the benefit of members of plan 002, not for members of other plans. Because PacifiCare did not use the MMA payment increase as stated in its revised proposal, plan 002 enrollees did not benefit in the contract year or afterward, as required by Medicare.

INTRODUCTION

BACKGROUND

Medicare Overview

Under Title XVIII of the Social Security Act, the Medicare program provides health insurance to Americans age 65 and over, those who have permanent kidney failure, and certain people with disabilities. Within the Department of Health and Human Services, the Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS).

The Balanced Budget Act of 1997 (Public Law 105-33) established Part C of the Medicare program. Part C offered beneficiaries a variety of health delivery models, including Medicare+Choice organizations. These organizations assumed responsibility for providing all Medicare-covered services, except hospice care, in return for a predetermined capitated payment.

The Medicare Prescription Drug, Improvement, and Modernization Act (MMA) of 2003 revised Part C, including changing the name Medicare+Choice to Medicare Advantage.

Proposal Requirements

At the time of our review, Medicare regulations required each Medicare Advantage organization (MAO) participating in the Medicare Advantage program to complete, for each plan, an annual adjusted community rate proposal (proposal) that contained specific information about benefits and cost sharing. The MAO had to submit the proposal to CMS before the beginning of each contract period.

CMS used the proposal to determine if the estimated capitation paid to the MAO exceeded what the MAO would charge in the commercial market for Medicare-covered services, adjusted for the utilization patterns of the Medicare population. MAOs had to 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 were not overcharged for the benefit package being offered.

Requirements of the Medicare Prescription Drug, Improvement, and Modernization Act

The MMA provided increased capitation payments to MAOs effective March 2004. For plans with increased capitation payments, the MMA required MAOs to submit revised proposals that identified how they would use the increased payments during contract year 2004. The CMS instructions for the revised proposals required MAOs to (1) submit a cover letter summarizing how they would use the increased payments and (2) support entries that changed from the original filing.

PacifiCare's Revised Proposals

For contract year 2004, PacifiCare of Colorado (PacifiCare) submitted the required revised proposals for contract number H0609, representing plan numbers 002, 003, 006, 007, 008, and 8.01. We limited our review to plan numbers 002, 006, and 007. The three cover letters for the revised proposals reflected a combined increase in Medicare capitation payments provided by the MMA legislation of about \$5.1 million, or \$12.59 per member per month (weighted average). Each of the three cover letters stated that PacifiCare would use the MMA payment increase to:

- reduce beneficiary premiums,
- enhance benefits, and
- stabilize or enhance beneficiary access to providers.

Established as a health maintenance organization in 1974, PacifiCare has steadily grown to become one of the largest health plans in Colorado. PacifiCare provides a variety of health plan options. CMS contracted with PacifiCare as an MAO to provide health care coverage to approximately 50,000 Medicare enrollees during our audit period.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether PacifiCare's use of its MMA payment increase was adequately supported and allowable pursuant to the MMA.

Scope

Our review covered the \$5,148,375 increase in contract year 2004 Medicare capitation payments provided by the MMA legislation for PacifiCare's contract number H0609, plan numbers 002, 006, and 007.

Our objective did not require us to review the internal control structure of PacifiCare.

We conducted our review from September through December 2005 and performed fieldwork at PacifiCare's field office in Santa Ana, CA.

Methodology

To accomplish our objective, we:

- reviewed applicable Federal laws, regulations, and guidance;
- reviewed the cover letters that PacifiCare submitted with its revised proposals, in which PacifiCare stated how it would use the MMA payment increase;

- compared the initial proposals with the revised proposals to determine PacifiCare’s modifications;
- reviewed the supporting documentation for the proposed use and actual use of the MMA payment increase; and
- interviewed PacifiCare officials.

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

FINDINGS AND RECOMMENDATION

Of the \$5,148,375 capitation payment increase in PacifiCare’s revised proposals, \$5,013,375 was adequately supported and allowable pursuant to the MMA. The remaining \$135,000 was adequately supported; however, PacifiCare did not use these funds to enhance access to providers under plan 002 as stated in its revised proposal. Instead, PacifiCare used the funds to enhance access to providers by opening a new medical facility serving beneficiaries enrolled in plans 006 and 007. Since plan 002 enrollees did not benefit from the \$135,000 of increased capitation payments, PacifiCare’s use of the payments was unallowable.

FEDERAL REQUIREMENTS FOR MMA PAYMENT INCREASES

Section 211 of the MMA allows MAOs to use the MMA payment increases to:

- reduce beneficiary premiums,
- reduce beneficiary cost sharing,
- enhance benefits,
- contribute to a benefit stabilization fund, or
- stabilize or enhance beneficiary access to providers.

Federal regulations (42 CFR 422.310(a)(1)) require that each MAO compute a separate adjusted community rate for each plan offered to Medicare beneficiaries. Federal regulations (42 CFR § 422.310(c)(5)) also require that MAO proposal rates be supported.

The “Medicare Managed Care Manual,” chapter 8, section 80.2, states that when a proposal shows an excess amount, the MAO must make certain adjustments to the proposal that will eliminate the excess and benefit plan enrollees in the contract year or afterward. The MAO has the option of contributing the excess amount to a stabilization fund, adding additional health care benefits, or lowering the limit on the premiums and cost sharing that it can charge to plan enrollees.

ACCESS TO PROVIDERS NOT ENHANCED OR STABILIZED

Pursuant to section 211 of the MMA, PacifiCare proposed to use \$720,000 of the \$5,148,375 capitation payment increase to enhance or stabilize access to providers by opening new medical facilities. Specifically, in its revised proposals, PacifiCare proposed to use \$585,000 to establish two medical practices in the Denver area for enrollees in plans 006 and 007 and \$135,000 to establish one medical practice in the Colorado Springs area for enrollees in plan 002 by entering into a contract with a medical consulting group.

Subsequently, the consulting group amended the contract, and PacifiCare used the total of \$720,000 to establish one medical practice in the Denver area for enrollees in plans 006 and 007. Since PacifiCare did not establish a medical practice in the Colorado Springs area as stated in its revised proposal, PacifiCare failed to enhance or stabilize access to providers in that area. As a result, plan 002 enrollees did not benefit from the MMA payment increase in the contract year or afterward, as required by the “Medicare Managed Care Manual.”

RECOMMENDATION

We recommend that PacifiCare refund to the Federal Government \$135,000, representing the portion of the MMA payment increase that was not used pursuant to the MMA.

PACIFICARE’S COMMENTS

In its comments on the draft report, PacifiCare generally agreed with the facts presented. However, PacifiCare disagreed with our finding that it did not enhance or stabilize access to providers in plan 002 by not adding a medical practice in the Colorado Springs area. PacifiCare stated that enhanced or stabilized access to providers was not solely dependent upon adding a new medical practice. Further, PacifiCare stated that the MMA funding to establish a new medical practice allowed PacifiCare to work with an existing provider group to strengthen the provider network, and therefore, enhance or stabilize members’ access. Finally, PacifiCare stated that the vast majority of the MMA funding was used precisely as indicated in its revised proposals and that the \$135,000 we recommended for refund was used in support of other plans covered by the same contract.

The full text of PacifiCare’s comments is included as an appendix to this report. Where appropriate, we made changes in the body of the final report to reflect PacifiCare’s comments.

OFFICE OF INSPECTOR GENERAL’S RESPONSE

CMS approved PacifiCare’s revised proposal to use \$135,000 to enhance or stabilize access to providers by adding a new medical practice to serve beneficiaries in plan 002. However, PacifiCare did not establish a medical practice in the Colorado Springs area as stated in its revised proposal. In addition, PacifiCare did not provide us with evidence indicating how it strengthened the provider network under plan 002 to enhance or stabilize members’ access.

We agree that PacifiCare spent \$135,000 of the MMA payment increase on other plans covered by the same contract. However, CMS approved the \$135,000 increase to be used for the benefit of members of plan 002, not for members of other plans. Because PacifiCare did not use the MMA payment increase as stated in its revised proposal, plan 002 enrollees did not benefit in the contract year or afterward, as required by Medicare.

APPENDIX

February 28, 2006

Ms. Lori A. Ahlstrand
Regional Inspector General for Audit Services
U.S. Department of Health & Human Services
Office of Inspector General
Office of Audit Services, Region IX
50 United Nations Plaza, Room 171
San Francisco, CA 94102

Subject: Report Number A-09-05-00077

Dear Ms. Ahlstrand:

PacifiCare appreciates the opportunity to respond to the Office of Inspector General, Office of Audit Services on its draft audit report titled, "Review of PacifiCare of Colorado's Modifications to Its 2004 Adjusted Community Rate Proposal Under the Medicare Prescription Drug, Improvement, and Modernization Act" (Report Number A-09-05-00077).

Statements of Concurrence/Nonconcurrence

PacifiCare largely concurs with the facts presented in the draft report with the exception of two clarifications, which are presented later in this response, and the following.

We do not concur with the page 4 conclusion that "[s]ince PacifiCare did not establish a medical practice in the Colorado Springs area as stated in its revised proposal, PacifiCare failed to enhance or stabilize access to providers in that area." Enhanced or stabilized access to providers was not solely dependent upon adding the medical practice.

PacifiCare had planned to enhance or stabilize access by transitioning members from an underperforming provider group to the planned new medical practice. However, the existing provider group responded by agreeing to changes that would allow us to enhance or stabilize access without the need to add a new medical practice. Although we had already filed the ACRs, we decided the members would be best served by allowing them to keep the existing provider network and not be forced to change physicians.

Additional Information

It is worth noting several circumstances from early 2004. The timeline for filing MMA ACRs in January 2004 allowed MAOs very little time to decide the use of the additional funding, negotiate provider contracts, where needed, and then complete and file the ACRs with CMS. The ACRs reflected the MAOs' intent at the time of the filing. In PacifiCare's case, the option not to add the Colorado Springs medical practice did not present itself until after the ACRs were filed.

Also, we wish to underscore the fact that the dollars in question were spent in support of other plans within this contract, not retained by the MAO.

Clarifications to the Draft Audit Report

We wish to clarify a few portions of the draft audit report. The first is on page 1, under *Proposal Requirements*, which says that "MAOs had to use any [Medicare capitation] excess as prescribed by law, including...accepting a capitation payment reduction for the excess amount." This option, while historically correct, was eliminated several years prior to the audit period.

The second is on page 2, under *PacifiCare's Revised Proposals*. The last sentence of that section states that the MAO had "approximately 581,046 Medicare enrollees" during the audit period. In fact, that total represents member months for the year, whereas the MAO had a little less than 50,000 members, or enrollees, during the audit period.

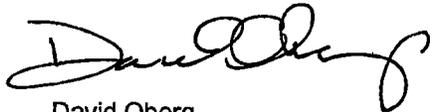
Closing

PacifiCare appreciates the opportunity to respond to the draft audit report. We agree with much of the report; however, we respectfully disagree with the conclusion that by virtue of not adding a medical practice for plan 002 PacifiCare did not enhance or stabilize members' access to providers. The events that unfolded in early 2004 demonstrate that the MMA funding and the resulting plan to establish a new medical practice allowed us to work with an existing provider to strengthen the provider network and, therefore, enhance or stabilize members' access.

Furthermore, the vast majority of the MMA funding was used precisely as proposed in the ACRs. The remaining dollars, as noted in the draft audit report, were used in support of other plans within the same contract.

Please contact me should you have additional questions at (714) 226-3810

Sincerely,



David Oberg
Director, Regulatory Affairs

ACKNOWLEDGMENTS

This report was prepared under the direction of Lori Ahlstrand. Other principal Office of Audit Services staff who contributed include:

Jerry McGee, *Audit Manager*
Danuta Biernat, *Senior Auditor*
Binh Quach, *Auditor*

For information or copies of this report, please contact the Office of Inspector General's Public Affairs office at (202) 619-1343.