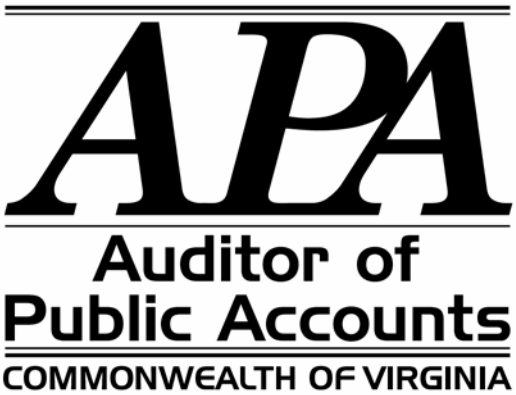
DEPARTMENT OF
MEDICAL ASSISTANCE SERVICES

REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2006



AUDIT SUMMARY

Our audit of the Department of Medical Assistance Services for the year ended June 30, 2006, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- a weakness in internal controls that require management's attention and corrective action;
- no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards; and
- adequate corrective action for prior year audit findings.

RISK ALERT

Background

During the course of our audits, we encounter issues which are beyond the corrective action of management and requires the action of either another agency, outside party, or the Commonwealth of Virginia (Commonwealth) to change its method by which it conducts its operations. The following matter represents a risk to the Department of Medical Assistance Services (Department), but the Department must rely on the Virginia Department of Social Services and the Local Departments of Social Services.

Evaluate the Adequacy of the Eligibility Determination Process

Ensuring that only eligible recipients receive benefits is a critical control and compliance issue facing the Department. The Code of Virginia requires the Department to contract with the Virginia Department of Social Services (Social Services) to determine which individuals are eligible to participate in the Medicaid program. The Department pays Social Services just over $50 million annually for this service.

Social Services uses its network of Local Departments of Social Services to determine an individual's Medicaid eligibility. Social Services provides Local Departments of Social Services employees training and an automated system controlled by Social Services to assist in determining eligibility. Local Departments of Social Services are units of the local government they serve and Social Services uses the funding from the Department to pay the local governments for this service.

The Department, Social Services, and the Local Departments of Social Services clearly share responsibility for determining eligibility for the Medicaid program. However, the federal government holds the Department as the Commonwealth's administrator of the Medicaid Program, as the ultimate party responsible if ineligible individuals use the program.

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AUDIT FINDING AND RECOMMENDATION

Address Findings in Internal Audit Report

We concur with the findings in the Department's Internal Audit report on the Department's Operating Environment and Information Security Business Processes issued in May of 2006. This report recommended improving security documentation and strengthening certain security processes. Given the sensitivity of the information the Department is responsible for, management should continue in its efforts to address their findings.

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The Department, Social Services, and the Local Departments of Social Services clearly share responsibility for determining eligibility for the Medicaid program. However, the federal government holds the Department as the Commonwealth's administrator of the Medicaid Program, as the ultimate party responsible if ineligible individuals use the program.

The federal government would require the Department to reimburse the program for both the federal and state share of any of the program's costs that are spent on an ineligible participant. Since the Department has no independent funding stream, this situation would result in additional costs to the Commonwealth's General Fund. Depending on the circumstances, the Department could attempt to retrieve the payments from an external party, however, this is unlikely. This means that eligibility errors made by Local Departments of Social Services could require the Department to make payments to the federal government. Currently, beyond the specific limited reviews required by the federal government there is no ongoing systematic process for evaluating how good Local Departments of Social Services are at determining eligibility.

The Department and Social Services are seen as equal entities within the structure of the state government, which prevents the Department from managing its agreement with Social Services as it would with an external vendor providing eligibility determination services. Furthermore, neither the Department nor Social Services believe that they have the authority or the ability to hold the Local Departments of Social Services financially accountable for not performing.

The federal government does not specifically require the Commonwealth to do an ongoing systematic review of its eligibility determination process and does not provide incentives for completing such reviews. The federal government has not established an acceptable error rate for the Medicaid program, therefore the Department is required to cover the cost of every ineligible person identified in the program, even if there was no fraud or other deceit. These inactions by the federal government do not encourage the Commonwealth to develop an ongoing process for monitoring and evaluating the effectiveness of controls surrounding the eligibility determination process.

The forced relationship between the Department, Social Services and Local Departments of Social Services puts the Medicaid program and the Commonwealth at risk that ineligible participants could enter the program and go undetected due to the failure of Local Departments of Social Services to properly determine eligibility. The Commonwealth needs to allow the managers of the Medicaid program to take cross-organizational actions to ensure the highest level of accuracy in ensuring participant eligibility.

FOLLOW-UP TO PRIOR YEAR AUDIT FINDING

The Department is adequately progressing through their multiyear corrective action plan to a prior year's audit funding, entitled: Implementation of a System-wide Strategy for Utilization Units. During our prior audit, we found control weaknesses amongst the Department's Utilization Units. The Units did not have sufficient resources to complete their review plans due to employee turnover and changing priorities. Management is working to address these issues through a combination of Unit reorganization and the selective outsourcing of the work required to identify irregularities and maintain proper internal controls. We agreed with management's corrective action plan and are monitoring its implementation.

Management hired the accounting firm Clifton and Gunderson to help develop and implement the Department's agency-wide plan for the Utilization Units. Based upon this plan, the Department's divisions reorganized and outsourced selective data mining and audit services. To allow management to more accurately evaluate the effectiveness of the various units across different divisions, the Program Integrity Unit and the Long Term Care and Quality Assurance divisions established measurable performance expectations for their staff and their units. Additionally, during the past fiscal year, the Department increased staff, revised policies and procedures, retrained necessary staff, and improved relationships with the Medicaid Fraud Control Unit.

Furthermore, the Department has placed greater emphasis on provider program integrity, as several divisions have become more consciously involved in either a leading or supporting role. The Department focused their strategy for preventing waste and abuse.

Better management of provider networks - The Department's Medicaid Management Information System (MMIS) now interfaces with the U.S. Department of Health and Human Services' Centers for Medicare & Medicaid Services' (CMS) system to prevent CMS-excluded providers from participating in Virginia's Medicaid program. Additionally, the Department now formally receives notification if a CMS-excluded provider tries to enroll in Virginia's Medicaid program.

Similar to the MMIS to CMS interface, the Department is currently negotiating with Managed Care Organizations (MCO) to exchange information on providers terminated from MCO networks. Obtaining this information will enhance the Department's ability to exclude undesirable providers from the Medicaid program.

Finally, the Department is changing their provider agreements to include a 30-day notice of termination clause that will facilitate the termination of unwanted providers. The Attorney General's office is reviewing the Department's termination process recommendations and provider contract language.

Pre and post-payment claim utilization reviews and audits - In addition to the Department's edits within MMIS to prevent common, prepayment billing errors the Program Operations Division, in January 2006 implemented a software package, which evaluates claims based on certain bundling logic prior to reimbursement.

Presently, as a result of the increased scrutiny, the Department is averaging approximately $110,000 in savings per week from medical laboratories alone. Management hopes to save $4.5 million by December 2006.

We are encouraged by the Department's improvements; and urge management to continue following their corrective action plan. We will continue to monitor the Department's action plan implementation into the next fiscal year.

AGENCY HIGHLIGHTS

The Department administers the Commonwealth's health care programs for eligible persons with limited income and resources. These programs include Medicaid, Family Access to Medical Insurance Security (FAMIS), Medical Assistance for Low-Income Children (FAMIS Plus), the Indigent Health Care Trust Fund, Income Assistance for Regular Assisted Living, Involuntary Mental Commitments, the Virginia Health Care Trust Fund, and other medical assistance services such as HIV assistance and state and local hospitalization.

Tables 1 and 2 summarize the Department's budgeted revenues and expenses compared with actual results and table 3 summarizes actual program expenses by fund source for the year ended June 30, 2006.

Table 1

Analysis of Budgeted and Actual funding by Source – Fiscal Year 2006

Funding Source	Original Budget	Adjusted Budget	Actual
Federal grants	$2,520,698,871	$2,544,845,757	$2,545,437,302
General Fund appropriations	2,152,985,491	2,196,206,063	2,196,206,063
Virginia Health Care Fund	310,432,161	312,455,153	288,785,889
Other special revenue	21,915,627	22,840,627	25,186,565
Total resources	$5,006,032,150	$5,076,347,600	$5,055,615,819

Source: Appropriation Act Chapter 951, Adjusted Budget - CARS 1419D1 Report, Actual - CARS 402 Report

The Department adjusted its original general and federal fund budgets primarily for inflation in Medicaid costs and for providing services to an increasing number of low-income children, elderly, and disabled persons. The Department's actual budget was only one percent higher than its original budget. Revenue for federal grants exceeded their budget due to how the State Comptroller accounts for pass-through funds in the Commonwealth Accounting and Reporting System (CARS). The Department receives the funds as revenue then transfers the money to other agencies, such as Social Services, which budgets and spends the funds. During fiscal 2006, the Department received and transferred $52 million in federal funding to Social Services for determining if individuals are eligible for the Medicaid program.

Virginia Health Care Fund

The Virginia Health Care Fund (Fund) accounts for the collection and disbursement of state funds dedicated for the Medicaid Program. Between fiscal year 2005 and 2006 the Fund only experienced a $9.9 million decrease in revenues, $314.6 million to $302.7 million, but saw major changes in its funding sources. Prior to fiscal year 2006 intergovernmental transfers provided additional revenue for the Fund. In fiscal year 2005 alone, intergovernmental transfers provided $95 million in revenue. In fiscal year 2006, the U.S. Department of Health and Human Services Centers for Medicare and Medicaid Services (CMS) prohibited states from using these transfers as a funding source. The Commonwealth made up the difference largely through the increases in the excise tax rate on cigarettes.

Tobacco taxes in fiscal year 2006 provided the Fund with a majority of its funding, 81 percent. Tobacco taxes have become a volatile funding source, and the Administration projects a $47.7 million decline in 2007 revenue for the Virginia Health Care fund., since tobacco tax revenues are running about seven percent lower than projections. Declines in this funding stream will require the Department to seek out increases from other funding sources or decrease their expenses.

Table 2

Analysis of Budgeted and Actual Expenses by Program – Fiscal Year 2006

Program	Original Budget	Final Budget	Expenses
Medicaid	$4,741,294,922	$4,809,160,066	$4,772,677,270
Administration and support services	75,520,971	92,067,560	86,442,530
FAMIS	92,526,663	80,816,941	79,676,988
FAMIS (Plus)	60,387,939	58,891,985	58,230,336
Medical assistance services (non-Medicaid)	14,222,481	14,997,481	13,271,627
Appellate processes	11,180,391	9,514,750	8,524,981
Indigent Health Care Trust Fund	9,285,831	9,285,865	6,848,175
Continuing income assistance services	1,612,952	1,612,952	1,308,664
Total	$5,006,032,150	$5,076,347,600	$5,026,980,571

Source: Original Budget - Appropriation Act Chapter 951, Adjusted Budget and Actual - CARS 1419D1 Report

Table 3

Analysis of Expenses by Program Funding Source – Fiscal Year 2006

Program	Federal Funds	General Fund	Virginia Health Care Fund	Other Special Revenue
Medicaid	$2,377,807,008	$2,084,253,018	$309,100,000	$1,517,244
Administration and support services	54,246,191	31,805,358	-	390,981
FAMIS (with administrative costs)	51,921,955	15,277,033	-	12,478,000
FAMIS (Plus)	37,852,324	20,378,012	-	
Medical assistance services (non-Medicaid)	-	11,340,630	-	1,930,997
Appellate processes	-	8,524,981	-	
Indigent Health Care Trust Fund	-	4,285,830	-	2,562,345
Continuing income assistance services	-	1,308,664	-	-
Total	$2,521,827,478	$2,177,173,526	$309,100,000	$18,879,567

Source: CARS 1419D1 Report

Total Department expenses for all programs amounted to $5.03 billion in fiscal 2006, a nine percent increase over the prior fiscal year. The increase is primarily due to inflation in health care costs and for providing services to an increasing number of recipients. The elderly population in Virginia continued to increase as more individuals reach age 65 and the federal initiative Insure Kids Now! put pressure on the Department to increase the enrollment of both FAMIS and FAMIS PLUS. Approximately 98 percent of total expenses represent medical expenses attributable to the Medicaid, FAMIS, and FAMIS Plus programs. Another 1.5 percent of the total amount represents administrative expenses for these three programs.

Medicaid

The Department spent $4.77 billion on Medicaid Assistance Services. The following table shows total medical expenses for the Medicaid program by provider type.

Table 4

Medicaid Expenses by Provider Type – Fiscal Years 2002-2006

	2006	2005	2004	2003	2002
Managed care organizations	$1,095,933,435	$ 967,584,252	$ 822,941,745	$ 768,548,306	$490,879,442
Nursing facility	697,984,269	646,567,758	623,759,124	582,787,725	539,268,035
Inpatient hospital - regular	597,176,255	524,024,992	483,247,785	402,014,317	401,859,141
Home and community-based waivers	517,902,524	446,368,368	401,779,716	352,596,635	318,007,100
Prescribed drugs	458,755,750	611,762,626	568,887,798	498,672,240	445,195,673
Mental health facility	378,320,413	290,003,507	247,075,233	222,858,621	185,491,843
Medicare premiums	223,836,995	133,112,503	119,820,295	90,894,139	97,298,222
ICF/MR public facilities*	203,883,991	195,854,274	193,136,174	178,053,785	218,492,490
Physician	153,891,820	155,456,154	139,550,896	122,063,767	127,307,456
Other care services	121,814,234	106,424,576	46,242,252	46,785,117	49,710,397
Outpatient hospital	115,024,648	126,288,370	99,455,728	111,118,885	107,438,441
Inpatient hospital - enhanced disproportionate share	92,198,332	111,561,611	72,675,032	121,359,950	122,513,616
Dental	55,624,772	13,750,693	12,677,140	12,026,005	12,774,312
ICF/MR/ private facilities*	40,532,655	34,036,235	25,460,429	21,127,148	18,299,608
Clinic	34,847,625	36,767,116	33,984,103	33,846,096	34,756,028
Hospice benefits	19,630,462	16,023,355	9,514,896	9,613,604	7,045,884
Targeted case management	18,251,710	15,782,932	14,916,263	17,714,882	17,352,425
Lab and radiological	16,878,893	17,067,491	14,364,597	13,551,057	13,052,372
Other practitioners	14,138,844	13,651,485	12,444,294	13,072,417	12,562,381
Federally-qualified health center	10,306,511	7,066,424	3,608,087	1,915,894	1,940,064
Early and periodic screening, diagnosis, and treatment services	7,601,300	7,722,845	(1,267)	5,300,495	6,429,903
Rural health clinic	6,951,287	8,668,652	11,219,581	9,163,116	8,066,079
Home health	5,018,912	4,555,850	3,048,813	4,411,341	5,002,691
Prepaid health plans	3,176,990	3,959,700	3,596,304	3,722,002	2,811,449
Supplemental payments	1,247,944	20,953,016	23,693,732	57,129,557	500,821,602
Drug rebates	(118,253,301)	(120,600,610)	(91,636,289)	(73,263,453)	(65,610,593)
Total	$4,772,677,270	$4,394,414,172	$3,895,462,463	$3,627,083,648	$3,678,766,061

* Intensive care facility/mental retardation

Source: Department of Medical Assistance Services Statistical Report and prior year report

The December 2005 expansion of a managed care organization (MCO) into the Winchester Region (Frederick, Clarke, Warren, Shenandoah, Rappahannock, and Page counties) resulted in a 13 percent increase in MCO expenses between 2005 and 2006. Prescribed Drugs decreased due to the implementation of the Medicare Part D program. Medicare now pays for the prescription drugs for individuals who are eligible for both the Medicare and Medicaid programs; however, states are required to supplement the Medicare program, which is the reason for the large increase in Medicare Premiums. Dental expenses increased due to the Smiles for Children program which began in July 2005. Supplemental Payments decreased due to the fact that the Federal government disallowed intergovernmental transfers after June 30, 2005.

Administrative Expenses

In addition to medical assistance services, the Department spent $86.4 million on administrative costs. The tables below summarize the administrative expenses related to the Medicaid program.

Table 5

Medicaid Administrative Expenses – Fiscal Year 2006

Contractual services	$43,674,862
Personal services	23,538,434
Dental and medical services	13,393,036
Rent and other continuous charges	2,048,194
Property, plant, and equipment	1,522,337
Other	2,265,667
Total	$86,442,530

Source: CARS

Table 6

Administrative Contractual Service Payments – Fiscal Year 2006

First Health Services Corp	$21,710,657
West Virginia Medical Institute, Inc.	5,287,716
Clifton Gunderson And Co.	4,957,027
Maximus Inc.	1,509,830
Kepro Inc.	1,452,529
Other	8,757,103
Total	$43,674,862

Source: CARS

Administrative expenses increased by about $7.3 million but decreased as a percentage of overall medical spending. Forty-nine percent of the administrative expense increase is attributable to the increase in contractual services, a result of several new vendor contracts. The Department's fiscal agent, First Health Services, accounted for $21.7 million of all contractual expenses in fiscal 2006. First Health runs the day-to-day operation of the Medicaid program by processing claims and enrolling providers. First Health is also responsible for developing and maintaining the Department's Medicaid Management Information System and managing its preferred drug listing.

FAMIS AND FAMIS Plus

FAMIS' medical expenses amounted to $79.7 million, an increase of 22 percent over the prior year. Medical expenses for the FAMIS Plus amounted to $58.2 million, an increase of 36 percent. The increases can be attributed to Insure Kids Now!, a federal initiative, that has put pressure on states to increase enrollment in FAMIS and FAMIS Plus.

2006 INITIATIVES

Smiles for Children Program

The program, effective fiscal year 2006, provides coverage for diagnostic, preventive, and restorative/surgical procedures, as well as orthodontia services for Medicaid, FAMIS, and FAMIS Plus-enrolled children. The program also provides coverage for limited medically necessary oral surgery services for adults (age 21 and older). Doral Dental USA, the single dental benefits administrator, coordinates the delivery of all Smiles for Children dental services. To encourage more dental and specialty providers to enroll into the Department increased program fees for providers.

- Preliminary analysis of the first nine months of claims data indicates an upward trend in the number of children receiving care. According to a 2004 CMS report, about 29 percent of the children eligible for dental services received dental care. Current figures indicate that number has increased to about 37 percent. Additionally, the percentage of enrolled providers treating Medicaid patients and filing claims has increased by 29 percent since the program's inception. Finally, since the start of the program, the Department has had no complaints filed about access of care.(*Source of information: Smiles for Children Update for Centers for Medicare and Medicaid Services, June 1, 2006)*

Disease Management (DM) Program

The program's goals are to increase preventive care and promote self-management and verification of appropriate use of medical services for recipients currently with asthma, congestive heart failure, coronary artery disease, or diabetes. The Department contracted with the Health Management Corporation to implement the program in January 2006. The contractor has responsibility for providing outreach and education on the DM program, performing initial assessments, counseling and regularly assessing all program participants, and maintaining a 24-hour toll-free nurse call line for all program participants. The contractor also monitors clinical health outcome measures and track changes in Medicaid and FAMIS expenditures for participants in the DM program.

FAMIS Moms Program

This program encourages pregnant women to get early and regular prenatal care to increase the likelihood for a healthy birth outcome. Recipients receive comprehensive health care benefits during and for two months following the end of the pregnancy. FAMIS Moms took effect August 2005 and covers pregnant women from 133 to 166 percent of the federal poverty level, while Medicaid only covers pregnant women up to 133 percent.

Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

December 21, 2006

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Department of Medical Assistance Services** for the year ended June 30 2006.We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives

Our audit's primary objective was to evaluate the accuracy of the Department's financial transactions as reported in the Comprehensive Annual Financial Report for the Commonwealth of Virginia for the year ended June 30, 2006, and test compliance for the Statewide Single Audit. In support of this objective, we evaluated the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Department's accounting records, reviewed the adequacy of the Department's internal control, tested for compliance with applicable laws, regulations, contracts, and grant agreements, and reviewed corrective actions of audit findings from prior year reports.

Audit Scope and Methodology

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Accounts Payable	General System Controls
Accounts Receivable	Revenues
Expenditures	

We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, review of external and internal audit reports, inspection of documents including reconciliations, records, contracts, and board minutes. We reviewed appropriate sections of the Code of Virginia, the 2006 Acts of Assembly and federal regulations relevant to the Medicaid and FAMIS programs. We tested transactions and performed analytical procedures.

Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and other sources noted within the body of the report.

We noted certain matters involving internal control and its operation that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Agency is taking adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this letter.

Exit Conference and Report Distribution

We discussed this report with management on February 6, 2007. Management's and the Secretary of Health and Human Resources' responses have been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

GDS:sks
sks:

COMMONWEALTH of VIRGINIA

Office of the Governor

Marilyn B. Tavenner
Secretary of Health and Human Resources

February 6, 2007

MEMORANDUM

TO: Walter J. Kucharski
Auditor of Public Accounts

FROM: Marilyn B. Tavenner

DATE: February 6, 2007

SUBJECT: *Response to Risk Alert Included in the Audit Reports for the Department of Social Services and the Department of Medical Assistance Services*

I am writing in regard to the risk alert that was included in the recently completed audits of both the Department of Social Services (DSS) and the Department of Medical Assistance Services (DMAS).

Please know that DSS and DMAS will work together with other interested parties to address the eligibility issues raised in this risk alert. Both agencies will submit a letter to you in February detailing the steps they jointly will take to assist in the resolution of the identified eligibility issues.

Please let me know if you have any questions.

Cc: Anthony Conyers
Patrick Finnerty

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COMMONWEALTH of VIRGINIA

Department of Medical Assistance Services

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January 26, 2007

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

RE: Response to Audit Finding

Dear Mi. Kucharski:

The following is our reply to the audit finding:

Address Findings in Internal Audit Report

We concur with the findings in the Department of Medical Assistance Services' (Department) Internal Audit report on the Department's Operating Environment and Information Security Business Processes issued in May of 2006. This report recommended improving security documentation and strengthening certain security processes. Given the sensitivity of the information the Department is responsible for, management should continue in its efforts to address their findings.

DMAS Reply

DMAS concurs with the finding. We are implementing our corrective action plan for all the points contained in the Internal Audit report. Many of these issues are complex which effects our overall corrective action completion date which we estimate to be October 2007 at the latest, with the majority of the issues addressed by the end of the first quarter.

If you have any questions, please contact our Internal Audit Director, Mr. Charles W. Lawver at 786-0241.

Sincerely,

Patrick W. Finnerty
Director

cc. Charles Lawver
Cindi Jones
Cheryl Roberts
Scott Crawford

AGENCY OFFICIALS

Patrick Finnerty,
Agency Director

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