



Report to the Chairman,
Committee on Finance,
U.S. Senate

April 2017

MEDICAID DEMONSTRATIONS

Federal Action Needed to Improve Oversight of Spending

Accessible Version

GAO Highlights

Highlights of [GAO-17-312](#), a report to the Chairman, Committee on Finance, U.S. Senate.

Why GAO Did This Study

As of November 2016, 37 states had demonstrations under section 1115 of the Social Security Act, under which the Secretary of HHS may allow costs that Medicaid would not otherwise cover for state projects that are likely to promote Medicaid objectives. By policy, demonstrations must be budget neutral; that is, the federal government should spend no more for a state's Medicaid program than it would have spent without the demonstration. CMS is responsible for monitoring spending and assessing compliance with demonstration terms and conditions for how funds can be spent and applying spending limits to maintain budget neutrality.

GAO was asked to examine federal spending for demonstrations and CMS's oversight of spending. This report examines (1) federal spending over time, (2) CMS's monitoring process, and (3) CMS's application of spending limits. GAO reviewed federal expenditure data for fiscal years 2005-2015, relevant documentation for 4 states, selected based on variation among their demonstrations, and federal internal control standards, and also interviewed CMS and state Medicaid officials.

What GAO Recommends

GAO recommends that CMS (1) develop and document standard operating procedures for sufficient reporting requirements and to require consistent monitoring and (2) issue formal guidance on its revised policy for restricting accrual of unspent funds. HHS agreed with GAO's first recommendation and neither agreed nor disagreed with GAO's second recommendation.

View [GAO-17-312](#). For more information, contact Katherine Iritani at (202) 512-7114 or iritanik@gao.gov.

April 2017

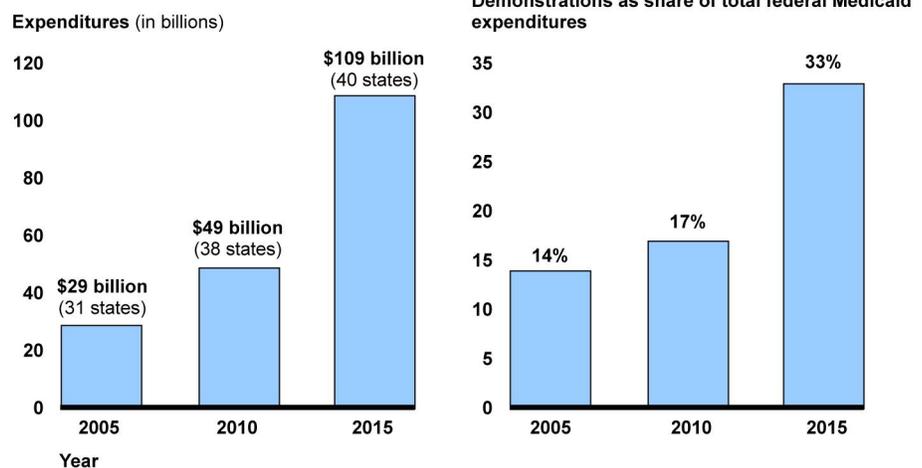
MEDICAID DEMONSTRATIONS

Federal Action Needed to Improve Oversight of Spending

What GAO Found

Over the last decade, federal spending under Medicaid section 1115 demonstrations, which allow states flexibility to test new approaches for delivering Medicaid services, has increased significantly.

Federal Expenditures under Medicaid Section 1115 Demonstrations, Fiscal Years 2005, 2010, and 2015



Source: GAO analysis of Centers for Medicare & Medicaid Services demonstration expenditures data, as of October 3, 2016. | GAO-17-312

The Centers for Medicare & Medicaid Services (CMS), within the Department of Health and Human Services (HHS), took a number of steps to monitor demonstration spending in GAO's 4 selected states. However, GAO also found inconsistencies in CMS's monitoring process. For example, CMS did not consistently require selected states to report the information needed to assess compliance with demonstration spending limits. The inconsistencies may have resulted from a lack of written standard procedures. CMS officials told GAO that CMS was developing procedures to better standardize monitoring, but did not have detailed plans for doing so. Thus, it is too soon to determine whether these efforts will address the inconsistencies GAO found. Federal standards require that federal agencies design control activities to achieve objectives. Without standard, documented procedures, CMS may not identify cases where states are inappropriately using federal funds or exceeding spending limits.

In applying demonstration spending limits, CMS allowed states to accrue unspent funds (more specifically, unused spending authority) when state spending is below the limit and use them to finance expansions of the original demonstration. For example, CMS allowed New York to use \$8 billion in unspent federal funds to expand its demonstration to include an incentive payment pool for Medicaid providers. In May 2016, CMS released a slide presentation outlining new restrictions on the accrual of unspent funds. Per federal standards, formal guidance helps ensure that policies are consistently carried out. However, CMS has not issued formal guidance on the policy and does not consistently track unspent funds under the spending limit, raising questions as to whether the revised policy will be effective in better controlling costs.

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Abbreviations

CMS	Centers for Medicare & Medicaid Services
DY	demonstration year
HHS	Department of Health and Human Services
PPACA	Patient Protection and Affordable Care Act
STC	special terms and conditions

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April 3, 2017
The Honorable Orrin G. Hatch
Chairman
Committee on Finance
United States Senate

Dear Mr. Chairman:

In fiscal year 2015, federal spending for Medicaid section 1115 demonstrations, which allow states to test and evaluate new approaches for delivering Medicaid services, was over a \$100 billion.¹ As of November 2016, 37 states were operating a portion of their Medicaid program under one or more of these demonstrations. Under section 1115 of the Social Security Act, the Secretary of Health and Human Services may waive certain federal Medicaid requirements and allow costs that would not otherwise be eligible for federal funds for demonstration projects that, in the Secretary's judgment, are likely to promote the objectives of the Medicaid program.² For example, the Secretary has approved states' proposals to extend Medicaid coverage under the demonstrations to populations or services that would not otherwise be covered under traditional Medicaid. Under section 1115, the Secretary has also allowed states to use Medicaid funds to finance other types of costs, for example, those for state health programs or incentive payments to providers to improve access to and quality of care.

The Secretary of Health and Human Services has delegated responsibility for overseeing section 1115 demonstrations to the Centers for Medicare & Medicaid Services (CMS), the agency within the Department of Health and Human Services (HHS) that oversees Medicaid. CMS's oversight responsibilities include monitoring demonstrations. This includes assessing whether states are complying with requirements for how federal funds can be spent under the demonstration and with limits on the amount of federal funds that can be

¹The Medicaid program—a joint, federal-state program that finances health care coverage for low-income and medically needy populations, including children and aged or disabled adults—covered an estimated 81 million individuals at an estimated cost of \$524 billion in fiscal year 2015, including about \$330 billion in federal spending and \$194 billion in state spending.

²42 U.S.C. § 1315(a).

spent over the life of a demonstration, referred to as spending limits.³ CMS sets requirements for how funds can be spent, spending limits, how the limits will be enforced, and related state reporting requirements in the special terms and conditions (STC) for each demonstration, which represents the agreement between CMS and the state.

CMS policy requires that demonstrations be budget neutral to the federal government; that is, the federal government should spend no more for Medicaid under a state's demonstration than it would have spent without the demonstration. A demonstration's spending limit reflects CMS's estimate of what the federal government would have spent without the demonstration. Ensuring that demonstrations are budget neutral depends both on how limits are set and how CMS applies the limits during the course of the demonstration. GAO found in past work that approved spending limits for some demonstrations were too high and, therefore, did not ensure that demonstrations were budget neutral.⁴

Given the significant amount of federal spending under demonstrations, as well as past concerns about whether demonstrations were budget neutral, you asked us to examine federal spending for Medicaid demonstrations and CMS's monitoring of spending under demonstrations. This report examines the following:

1. Federal spending over time under Medicaid section 1115 demonstrations.
2. CMS's process for monitoring spending under section 1115 demonstrations.
3. CMS's application of demonstration spending limits.

To examine federal spending for Medicaid section 1115 demonstrations over time, we analyzed federal Medicaid expenditure data for fiscal years

³A demonstration is typically approved for an initial 5-year period and can be renewed, subject to HHS approval, for subsequent demonstration periods. Some states have demonstrations that have been in place for decades.

⁴See GAO, *Medicaid Demonstration Waivers: Recent HHS Approvals Continue to Raise Cost and Oversight Concerns*, [GAO-08-87](#) (Washington, D.C.: Jan. 31, 2008); *Medicaid Demonstration Waivers: Approval Process Raises Cost Concerns and Lacks Transparency*, [GAO-13-384](#) (Washington, D.C.: June 25, 2013); and *Medicaid Demonstrations: HHS's Approval Process for Arkansas's Medicaid Expansion Waiver Raises Cost Concerns*, [GAO-14-689R](#) (Washington, D.C.: Aug. 8, 2014).

2005 through 2015.⁵ Specifically, we reviewed data from CMS's Quarterly Medicaid Statement of Expenditures for the Medical Assistance Program—known as the CMS-64 form—extracted on October 3, 2016.⁶ We reviewed the federal share of expenditures for section 1115 demonstrations from fiscal years 2005 through 2015, including state-by-state and national expenditures. We analyzed spending under demonstrations as a share of total Medicaid spending over this time period.⁷ To assess the reliability of the federal expenditure data, we reviewed related documentation, including the forms used to collect the data and their instructions, and performed manual and electronic tests for outliers or anomalies. We also interviewed knowledgeable CMS officials about the data trends, quality, and limitations, including the steps they take to ensure data reliability. We determined that these data were sufficiently reliable for our purposes.

To examine CMS's process for monitoring spending under demonstrations, we reviewed documentation for demonstrations in four states: California, Indiana, New York, and Tennessee. We selected states with demonstrations that were at least 5 years old and that varied in terms of the approaches each state was testing under the demonstration. Our states also varied geographically. For each demonstration, we reviewed reporting requirements contained in the STCs that were in effect as of the end of 2015, as well as any renewals approved after that date.⁸ We also reviewed available quarterly and annual performance reports and quarterly expenditure reports for 2013 through 2015 submitted by those states to CMS to assess whether reports were consistent with reporting requirements. Finally, where relevant, we reviewed documentation of CMS deferrals of federal Medicaid funds—decisions to withhold payments to states until further review—related to the demonstrations in these

⁵Throughout the report, we refer to the federal fiscal year as fiscal year.

⁶We reviewed data for the 50 states and the District of Columbia. For the purposes of this report, we included the District of Columbia as a state. State Medicaid agencies submit expenditure information to CMS on a quarterly basis by means of the CMS-64 form within the Medicaid Budget & Expenditure System. CMS collects data on Medicaid expenditures under section 1115 demonstrations on specific lines of the form. States have 2 years to report expenditures. As such, fiscal year 2015 was the most recent year of data that we determined was sufficiently reliable.

⁷We included medical expenditures in our analysis and excluded administrative expenditures. Medical expenditures represent the vast majority of spending under demonstrations, about 98.7 percent in fiscal year 2015.

⁸Renewals are also referred to as extensions by CMS.

states. To supplement our review, we interviewed CMS officials about their monitoring practices in general and for the demonstrations in our selected states, and we interviewed state Medicaid officials in the four states. In evaluating this information, we compared policies and procedures against GAO's Standards for Internal Control in the Federal Government, which provide guidance to federal agencies on ensuring accountability.⁹

To examine how CMS applied demonstration spending limits, we interviewed CMS officials about their policy for applying spending limits and reviewed related documentation. We also reviewed the STCs for our selected states' demonstrations to examine how CMS's policies were reflected in the STCs. For the one selected state where sufficient data were available, we examined combined state and federal expenditures to compare actual spending to the demonstration spending limit.

We conducted this performance audit from September 2015 to April 2017 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 objectives.

Background

The federal government sets broad federal requirements for Medicaid—such as requiring that state Medicaid programs cover certain populations and benefits—and matches state Medicaid expenditures with federal funds for most services.¹⁰ States administer their respective Medicaid programs on a day-to-day basis, and have the flexibility to, among other things, establish provider payment rates and cover many types of optional

⁹GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014). Internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.

¹⁰The federal government matches most state Medicaid expenditures according to the state's Federal Medical Assistance Percentage. This percentage is calculated using a statutory formula based on the state's per capita income in relation to the national per capita income. In fiscal year 2015, the matching rates ranged from 50 percent to 73.6 percent.

benefits and populations. Section 1115 demonstrations provide a further way for states to innovate in ways that fall outside of many of Medicaid's otherwise applicable requirements, and to receive federal matching Medicaid funds for costs that would not otherwise be matchable. For example, states may use these demonstrations to test new approaches for delivering care to generate savings or efficiencies or improve quality and access. Such changes have included expanding benefits to cover populations that would not otherwise be eligible for Medicaid, altering the state's Medicaid benefit package, or financing payment pools, for example, for state-operated health programs or supplemental provider payments.¹¹ Demonstrations are typically approved for an initial 5-year period that can be renewed for future demonstration periods. Some states have operated some or all of their Medicaid programs for decades under section 1115 demonstrations.

Demonstration Terms and Conditions

Each demonstration is governed by STCs, which reflect the agreement between CMS and the state. The STCs include any provisions governing spending under the demonstration. For example, STCs indicate for what populations and services funds can be spent. In states receiving approval to implement payment pools for state health programs and supplemental provider payments, the STCs could include parameters for payments under those pools. For example, they may require that payment pools be capped at certain levels. The STCs may also include criteria for providers to receive payments and protocols that states must have to ensure the appropriateness of the payments and allow CMS to review those payments. The STCs also include the limits on the amount of federal funds that can be spent on the demonstration—referred to as spending limits—and indicate how spending limits will be enforced. Finally, the STCs include the reporting requirements the state must meet. Reporting requirements—as contained in the STCs—may include regular telephone calls between the state and CMS, regular performance reports, and

¹¹State-operated health programs could include outreach and treatment services for specific conditions, insurance subsidy programs, and workforce development programs. These programs could serve non-Medicaid populations.

A state may make supplemental payments—that is, payments in addition to base payments for covered services—to its hospitals and other providers, through the use of pools of dedicated funds—called funding pools—in its demonstration program. These funding pools may be used for uncompensated care, delivery system improvements, or for other various purposes such as graduate medical education.

quarterly expenditure reports. The STCs outline what the state should include in each of these reports, which can vary by demonstration.¹²

Demonstration Spending Limits

CMS policy requires that section 1115 demonstrations be budget neutral to the federal government—that is, the federal government should spend no more under a state’s demonstration than it would have spent without the demonstration. Once approved, each demonstration operates under a negotiated budget neutrality agreement, documented in its STCs, that places a limit on federal Medicaid spending over the life of the demonstration. This limit is referred to as the spending limit.¹³ If a state exceeds the demonstration spending limit at the end of the demonstration period, it must return the excess federal funds.

Spending limits can be a per person limit that sets a dollar limit for each Medicaid enrollee included in the demonstration in each month, a set dollar amount for the entire demonstration period regardless of the level of enrollment, or a combination of both. Spending limits are calculated by establishing a spending base and applying a rate of growth over the period of the demonstration. The spending base generally reflects a recent year of state expenditures for populations included in the demonstration, and the growth rate to be applied is generally based on the lower of a state-specific historical growth rate or a federal nationwide estimate.¹⁴ Different data elements may be required by CMS to assess a state’s compliance with the spending limit. For example, for a per person spending limit, which is generally a defined dollar limit per enrollee per month, CMS needs both expenditure and enrollment data to assess compliance with the spending limit.

¹²Performance reports include quarterly and annual reports on the topics that are listed in the STCs. These may be specific to the demonstration.

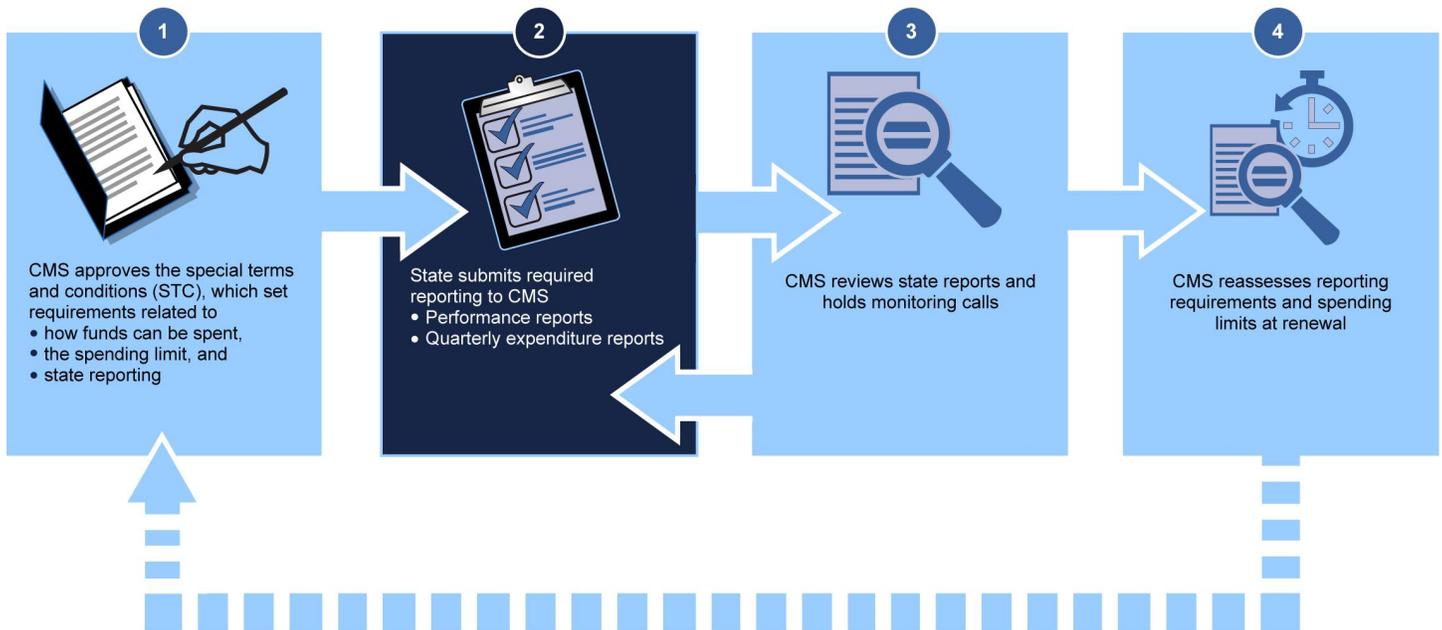
¹³According to CMS policy, the spending limits for demonstrations are to be based on the projected cost of continuing states’ existing Medicaid programs without a demonstration. The higher these projected costs, the higher the spending limit, and the more federal funding states are potentially eligible to receive for the demonstration, in the form of a federal match of their actual expenditures.

¹⁴CMS actuaries prepare nationwide projections of growth in preparing CMS’s annual budget estimates.

Demonstration Monitoring

CMS is responsible for monitoring compliance with the STCs during the demonstration, including compliance with requirements around how Medicaid funds can be spent and spending limits. Monitoring efforts may include reviewing performance reports and quarterly financial reporting required under the STCs and discussing questions and concerns with the state. When a state seeks a renewal of a demonstration, that request offers CMS an opportunity to negotiate revisions to the STCs with the state, which could include changes to spending limits and reporting requirements. (See fig. 1.)

Figure 1: Centers for Medicare & Medicaid Services (CMS) Oversight of Section 1115 Medicaid Demonstrations



Source: GAO. | GAO-17-312

States are required to report Medicaid expenditures, including expenditures under demonstrations, to CMS at the end of each quarter. CMS reviews these expenditures on a quarterly basis for reasonableness.¹⁵ If, during the expenditure review, CMS is uncertain as

¹⁵CMS reviews demonstration expenditures as part of the agency’s review of all Medicaid expenditures. In part, these reviews are used to reconcile state estimates of projected spending—on which basis CMS makes funds available to the states—with actual expenditures.

to whether a particular state expenditure is allowable, then CMS may withhold payment pending further review (referred to as a deferral).¹⁶ With regard to reporting on expenditures under demonstrations, the STCs dictate the level of detail that the state is required to include in the quarterly expenditure reporting. For example, they might require the state to report expenditures by population and by payment pool approved under the demonstration.

Federal Spending under Demonstrations Grew Significantly over the Past Decade and Represents a Third of All Medicaid Spending

Federal spending under section 1115 Medicaid demonstrations increased significantly from fiscal year 2005 through fiscal year 2015, rising from \$29 billion in 2005 to over \$100 billion in 2015.¹⁷ Federal spending on demonstrations also increased as a share of total federal Medicaid spending during the same period, rising from 14 percent of all federal Medicaid spending in fiscal year 2005 to 33 percent in fiscal year 2015. (See fig. 2.) Several factors likely contributed to these trends.¹⁸ First, the number of states with demonstrations increased during this period, with 31 states reporting demonstration expenditures in fiscal year 2005 and 40 reporting such expenditures in fiscal year 2015. Second, some states expanded their demonstrations over this period, with demonstration spending in 24 states representing a greater proportion of total Medicaid spending in fiscal year 2015 than in fiscal year 2005. For example, CMS officials told us that, during this period, some states shifted expenditures for managed care and home and community based services from other Medicaid authorities to section 1115 demonstrations.¹⁹ In addition, during

¹⁶CMS withholds the amount associated with the deferral from future funding for the state until the deferral is resolved.

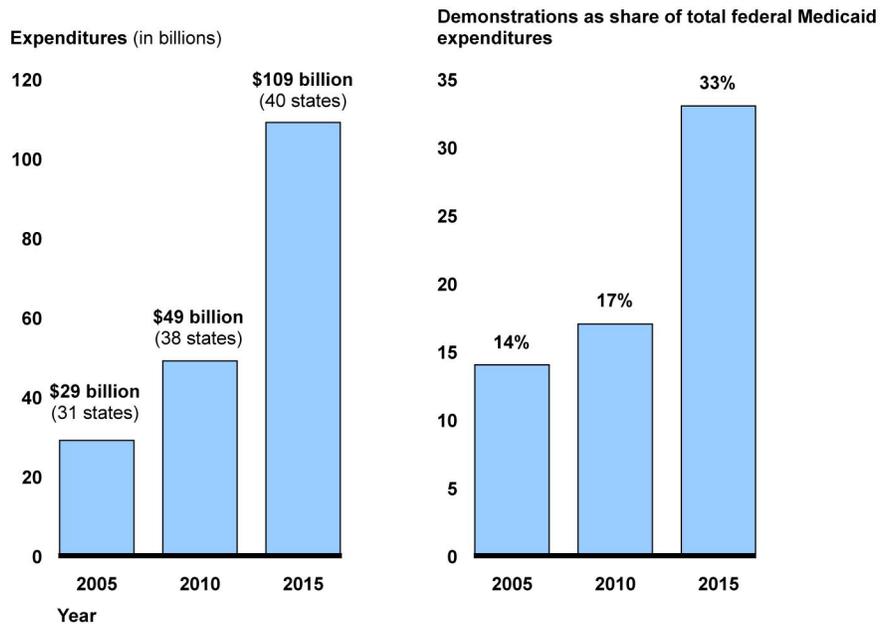
¹⁷For this analysis, expenditures were adjusted for inflation using the gross domestic product price index to 2015 dollars.

¹⁸We did not assess all of the factors that may have contributed to growth in federal demonstration spending during this period.

¹⁹Under a managed care delivery model, states typically contract with managed care organizations to provide a specific set of Medicaid-covered services to beneficiaries and pay them a set amount per beneficiary per month to provide those services. Home and community based services include such services as home health and adult day care and are available for individuals of all ages who have limited ability to care for themselves because of physical, cognitive, or mental disabilities or conditions.

2010 through 2015, a number of states expanded coverage through demonstrations to low-income adults, which, as CMS officials told us, likely contributed to the increase in demonstration spending.²⁰

Figure 2: Federal Expenditures under Medicaid Section 1115 Demonstrations, Fiscal Years 2005, 2010, and 2015



Source: GAO analysis of Centers for Medicare & Medicaid Services demonstration expenditures data, as of October 3, 2016. | GAO-17-312

Note: For this analysis, expenditures were adjusted for inflation using the gross domestic product price index to 2015 dollars. We included data on medical spending and excluded administrative costs.

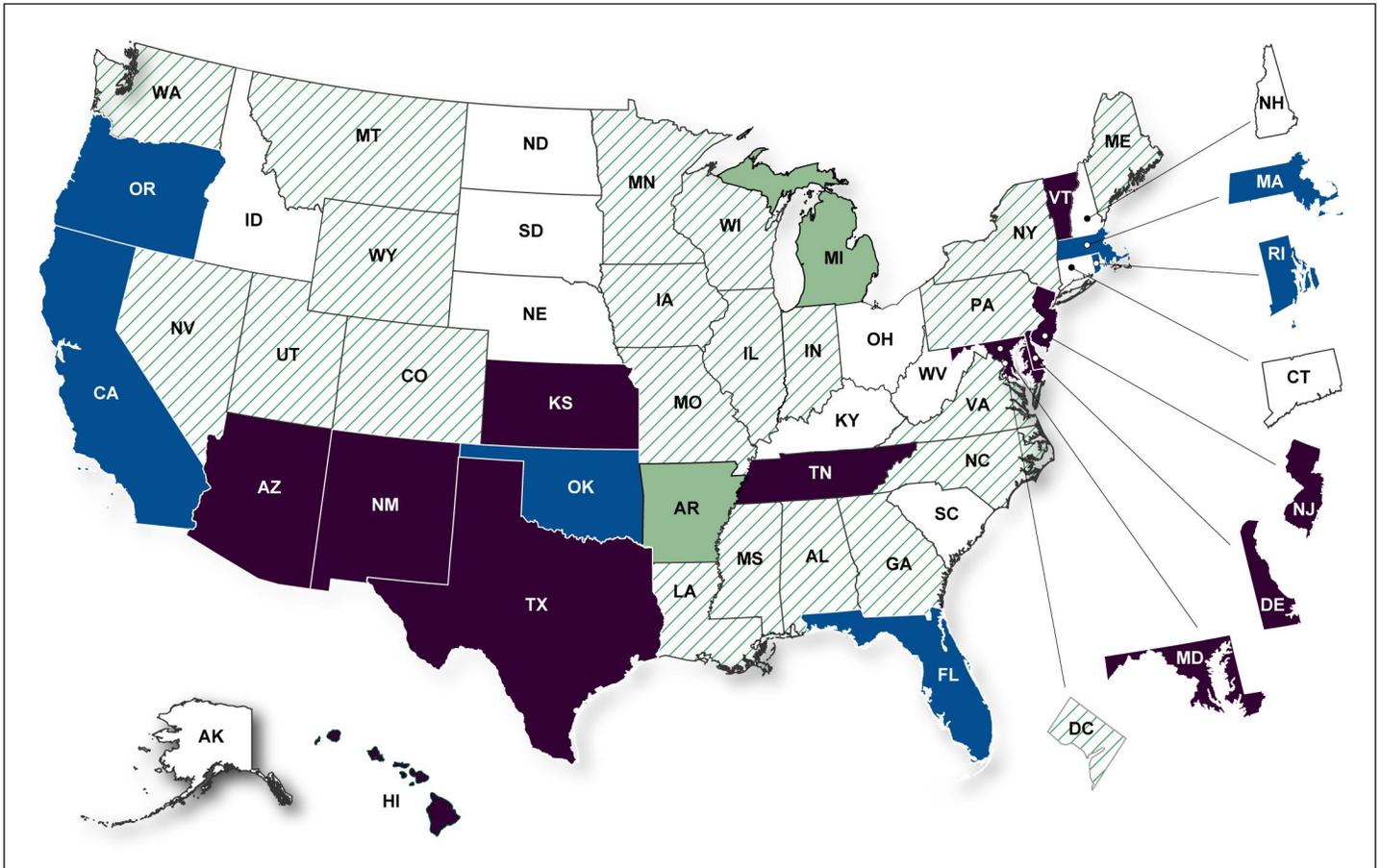
Demonstration spending as a proportion of total federal Medicaid spending varied across states and represented most—75 percent or more—of Medicaid spending in 10 of the 40 states that reported expenditures in fiscal year 2015. (See fig. 3.) Further, in 5 of these 10 states, demonstration spending represented more than 90 percent of the

²⁰In January 2014, the federal government began providing additional federal funds for the cost of covering low-income adults (individuals at or below 133 percent of the federal poverty level) newly eligible under the Patient Protection and Affordable Care Act (PPACA). The law also provides for a 5 percent income disregard when calculating an individual's income to determine Medicaid eligibility, which effectively raises the eligibility limit for these individuals to 138 percent of the federal poverty level.

state's total federal Medicaid spending.²¹ In contrast, in fiscal year 2005, spending under demonstrations did not exceed 75 percent of total Medicaid spending in any state. In that year, demonstration spending represented between 25 percent and 75 percent of total Medicaid spending in 10 states and less than 25 percent in 21 states. (See app. I.)

²¹Those five states whose reported demonstration expenditures exceeded 90 percent of their Medicaid expenditures were Arizona (99.7 percent), Hawaii (93 percent), Kansas (94 percent), New Mexico (93 percent), and Vermont (99 percent).

Figure 3: Federal Expenditures under Section 1115 Demonstrations as a Percentage of Total Federal Medicaid Expenditures, by State, Fiscal Year 2015



- No demonstration expenditures reported (**11 states**)
- Demonstration expenditures comprised less than 25% of total Medicaid expenditures (**22 states**)
- Demonstration expenditures comprised between 25 and 50% of total Medicaid expenditures (**2 states**)
- Demonstration expenditures comprised between 50 and 75% of total Medicaid expenditures (**6 states**)
- Demonstration expenditures comprised 75% or more of total Medicaid expenditures (**10 states**)

Source: GAO analysis of Centers for Medicare & Medicaid Services demonstration expenditures data, as of October 3, 2016; Map Resources (map). | GAO-17-312

Note: We included data on medical spending and excluded administrative costs. States have 2 years to report spending; therefore, states may have reported expenditures for fiscal year 2015 even if the state did not have an active demonstration that year. Data for New York may underestimate the proportion of total Medicaid spending that demonstration spending represented because New York's expenditure reporting for fiscal year 2015 was incomplete.

The extent to which demonstration spending changed over time varied across states, as illustrated by the most recent 5 years of spending data

in our selected states. In two of our four selected states—California and Indiana—spending under demonstrations increased between fiscal years 2011 and 2015, consistent with the national trend. (See table 1.) California’s demonstration spending increased the most significantly—more than tripling—during this time frame, during which the state expanded its demonstration to, among other things, provide coverage to low-income adults. Indiana reported a 22 percent increase in demonstration spending between fiscal years 2011 and 2015. In contrast, Tennessee reported a 3 percent decrease during that period. With regard to the change in the proportion of total Medicaid spending that demonstrations represented, the proportion did not change between 2011 and 2015 for Indiana and Tennessee and doubled in California, from a quarter of its total Medicaid expenditures in 2011 to half of its total Medicaid expenditures in 2015. We could not assess the change in spending for the fourth state—New York—because the state’s expenditure reporting for fiscal year 2015 was incomplete.²²

Table 1: Federal Medicaid Section 1115 Demonstration Expenditures for Selected States, Fiscal Years 2011 through 2015

State	2011 (in millions)	2015 (in millions)	Total for all years 2011-2015 (in millions)
California	\$8,804	\$29,272	\$76,450
Indiana	\$1,300	\$1,581	\$7,783
Tennessee	\$5,024	\$4,867	\$24,946

Source: GAO analysis of Centers for Medicare & Medicaid Services demonstration expenditures data, as of October 3, 2016. | GAO-17-312

Note: For this analysis, expenditures were adjusted for inflation using the gross domestic product price index to 2015 dollars. We included data on medical spending and excluded administrative costs.

CMS’s Monitoring of Demonstration Spending Lacked Consistency

We found that CMS took a number of steps to monitor demonstration spending in our selected states. For example, CMS held calls with states and performed various steps to assess the appropriateness of expenditures.

²²As of October 3, 2016, New York reported \$880 million for fiscal year 2015. By comparison, the state reported \$10.6 billion for 2014 and \$7.9 billion for 2013.

- **Held monitoring calls.** CMS and state officials told us that they held monitoring telephone calls to discuss any significant current or expected developments in the demonstrations.²³ CMS officials confirmed they may use the calls to obtain information to supplement their review of states' performance and expenditure reports. For example, CMS officials said they used the calls with Tennessee to raise questions about the content of the state's submitted quarterly reports. In addition, California officials told us that CMS used these calls to get updates and supporting documentation on state programs.
- **Checked for the appropriateness of expenditures.** In reviewing the quarterly expenditure reports, CMS officials told us that they assessed the appropriateness of expenditures. For example, the agency checked that the amounts claimed complied with federal requirements for matching funds. As a result of these checks, CMS issued several deferrals to withhold payment of federal funds to California until the state could account for expenditures claimed.²⁴ Officials also told us that as part of the checks, they assessed the appropriateness of pool payments, such as those for supplemental payments to providers, where relevant. Assessing the appropriateness of pool payments involves ensuring that pool payments align with the approved purposes of the pool and that the payments were made to approved providers.²⁵ For example, CMS officials told us that for one of the pools in the New York demonstration, agency staff checked whether the payments made were to eligible providers, the requirements of which were described in the STCs. As a result of this review, CMS deferred providing over \$38 million in federal funds to New York for payments made to providers under the pool in the quarter ending March 31, 2016, until the state could provide documentation that the providers were eligible to receive payment. CMS officials also told us that they checked to ensure that the state was not receiving funds

²³Although the STCs stipulate that monitoring calls be held monthly, both CMS and some state Medicaid officials confirmed that they can be held more frequently, and that the relationship between the state and the agency is such that calls can occur on an ad hoc basis.

²⁴For example, CMS deferred over \$140 million in federal funds claimed for a low-income health program approved under the demonstration. In the letter communicating the deferral decision to the state, CMS required that the state provide supporting documentation for the expenditures claimed.

²⁵Monitoring the appropriateness of payments made under the pools is important given that we previously reported on concerns that HHS has not always clarified what, precisely, approved pool expenditures are for and how they will promote Medicaid objectives. See [GAO-15-239](#).

from other federal funding sources that are intended to serve the same purposes as funds in their payment pools (i.e., duplicating federal funds), and that the state's share of funding for the pools is from permissible sources, such as the state's general revenue.²⁶ According to CMS officials, as a result of the agency's checks of spending for New York's demonstration, CMS identified \$172 million in federal funds that were inappropriately used to finance the state share of demonstration costs. CMS recovered these funds in fiscal year 2015.

However, we also found inconsistencies in CMS's monitoring process that potentially limited the effectiveness of the agency's monitoring efforts in the selected states. The inconsistencies included the following:

- **Reporting requirements were sometimes insufficient to provide information needed to assess compliance with spending limits.** CMS did not consistently require states to report the elements needed for the agency review staff to compare actual demonstration spending to the spending limit. For example, although CMS needs states to report the number of enrollees per month—referred to as member months—to assess compliance with per person spending limits, the agency only required such reporting for two of the four selected states' demonstrations. CMS acknowledged that having member month data is important to assess spending limit compliance.²⁷ For example, CMS did not require California to report enrolled member months for its demonstration from 2010 to 2015, but the agency amended the STCs to include this requirement when the state's demonstration was renewed beginning in 2016. Including this requirement will prevent CMS from having to use alternative means to gain necessary information for this compliance assessment. For example, CMS officials said that they have used monitoring calls to obtain the missing enrollment information from the state.
- **Enforcement of expenditure reporting requirements was inconsistent.** We found that the selected states did not report demonstration expenditures in all of the categories specified under

²⁶CMS performs checks for federal fund duplication and the source of the state's share of funds for pool payments given applicable restrictions in New York's STCs. CMS officials said that they did similar checks for the California and Tennessee demonstrations where applicable.

²⁷To assess compliance with a per person spending limit, CMS needs enrollment data, specifically, enrolled member months, from the state. CMS multiplies enrollment by the per person limit to get a total, and then compares actual spending to that total.

their demonstration STCs. For example, California's expenditure reporting did not align with the STC reporting requirements for 2010 through 2015. California officials told us this was largely because CMS had not enforced the reporting requirements prior to 2015. Therefore, based on our review, CMS would not be able to assess compliance with the spending limit for California using the data included in its expenditure report, if CMS tried to do so.²⁸

Financial Compliance Issues in California

As of the end of fiscal year 2013, California withdrew \$1.3 billion more in federal matching funds for its Medicaid program than it reported in actual expenditures, and according to CMS officials, California could not account for the difference. CMS had also issued California several deferrals to withhold payment of federal Medicaid funds in recent years, some of which related specifically to the demonstration. Despite those issues, CMS approved California's demonstration renewal for 2016. However, CMS required that the state work with the agency to resolve the expenditure issues as a condition of the renewal.

Source: GAO summary of documentation from the centers for medicare and Medicaid services

- **Monitoring compliance with spending limits was inconsistent.** CMS did not consistently assess compliance with the spending limit in all our selected states. CMS officials told us that they assessed compliance with the spending limits on a quarterly basis for the demonstrations in Tennessee and Indiana.²⁹ However, the agency did not regularly assess compliance for the California and New York demonstrations—which represented tens of billions of dollars in federal spending annually—due to limitations in the state-reported expenditure data.³⁰ CMS officials told us that they did not assess California's compliance with the spending limit because the expenditure data submitted by the state was not accurate. Furthermore, the agency's focus was on resolving a number of broader financial compliance issues in the state (see sidebar), the resolution of which, according to officials, was necessary before the agency could assess compliance with the spending limit. With regard to New York, CMS had not assessed compliance with the spending limit since 2011, because the state's reporting of expenditures has been significantly incomplete since then. According to CMS officials, significant staff transitions disrupted New York's ability to report expenditures to CMS as required. The state delayed reporting expenditures, and it did not report them in the categories specified in the STCs.³¹ Although CMS did not assess compliance with the

²⁸In August 2016, California officials told us that the state was in the process of modifying its expenditure system so that the reports will align with the STC requirements.

²⁹Our review of the demonstration documentation submitted by Tennessee and Indiana confirmed that the states submitted the enrollment and expenditure data that would be necessary for CMS to conduct regular assessments of compliance.

³⁰As previously mentioned, federal spending for California's demonstration was over \$29 billion in fiscal year 2015. New York's expenditure reporting for fiscal year 2015 was incomplete. However, the state reported \$10.6 billion in federal spending for its demonstration for fiscal year 2014.

³¹In December 2016, CMS approved a renewal of New York's demonstration and, as part of the renewal, required that New York work closely with the agency to bring its reporting into compliance with demonstration requirements by September 2017 or be subject to corrective action.

spending limit for either of these two states, officials told us that they were not concerned that California or New York exceeded their spending limits because the limits in those states have historically been higher than actual spending.

These inconsistencies may have resulted, in part, from CMS's lack of written, standard operating procedures for monitoring spending under demonstrations. For example, CMS does not have internal guidance on the elements that must be included in reporting requirements for states. In addition, regarding the state performance reports, CMS does not have a review protocol or a requirement that staff check that reports contain the elements required by the STCs, for example, enrollment data needed to assess a state's compliance with the spending limit. CMS has written materials to train staff on how spending limits are set and how demonstration spending is monitored. However, these materials are limited to high-level descriptions of the monitoring roles and do not contain specific procedures for staff to use in monitoring.³² Regarding the review of quarterly expenditure reports, CMS has guidance for agency staff who review them, but the guidance lacks detailed direction on what checks of demonstration expenditure data should occur.³³

CMS also lacks standard procedures for documenting its monitoring efforts. For example, the agency has no written requirements for its staff to document that required performance reports have been submitted by the states. Furthermore, the agency does not require its staff to document the content of monitoring calls, including any concerns and potential resolutions discussed. In addition, CMS does not require its staff to systematically document checks performed for state compliance with demonstration spending limits or the appropriateness of pool payments. According to CMS officials, while there are not written requirements to do so, there is an expectation that staff maintain documentation of their monitoring efforts. However, officials also told us that any documentation of checks that a demonstration complied with its spending limits is likely included in the personal notes of individual CMS staff. As such, they may not necessarily be accessible to all staff who have oversight responsibility of the demonstration. One example of evidence we observed of CMS documenting its monitoring efforts was when checks for appropriateness

³²CMS officials said that these training materials are used as a part of its required orientation program for new staff.

³³For example, the guidance instructs the reviewers to determine whether the expenditures reported are in compliance with the STCs and reported on the correct form.

of expenditures resulted in a deferral of federal funds, which were documented in letters to the states.

CMS officials told us that they are in the early stages of developing standard operating procedures and a management information system to better standardize the monitoring of demonstrations:

- **Standard operating procedures.** CMS officials told us that they are developing protocols for monitoring state demonstration programs and state compliance with demonstration spending limits. Officials told us that the protocols would outline staff roles and responsibilities. Officials also told us that they are working on standardizing the format and content of required state performance reports, which could help ensure that CMS is receiving the information needed to monitor spending under the demonstration. As of December 2016, CMS officials expected that the first phase of standard procedures, which will focus on assessments of compliance with the spending limit, will be developed and documented in the next year. They explained that developing the procedures is an iterative process and that it could take the agency 2 years to completely develop and document its plans.
- **Management information system.** CMS officials also told us that they are in the initial phases of building a management information system to facilitate and document demonstration oversight. The first part of the system, which was in use as of September 2016, allowed CMS to centralize the collection of state demonstration performance reports. In future phases of system development, officials told us that the system will include alerts for missing reports or incomplete reviews and prompts for CMS's staff to document completion of monitoring checks. CMS also plans for the system to include a database of demonstration STCs that CMS staff can search, which could help to ensure that STCs consistently include necessary reporting requirements.

It is too early to determine how well CMS's planned standard operating procedures and management information system will address the inconsistencies in its demonstration monitoring process. CMS officials did not have any written documentation regarding the agency's plans as of December 2016. As such, it was unclear, for example, whether the procedures and new system would include mechanisms to ensure that STCs consistently require states to report the information needed for CMS to assess compliance with the spending limits. In addition, it was unclear if the procedures or new system would ensure that agency staff

regularly check that expenditure reporting complies with reporting requirements. CMS officials said they intend for the procedures and new system to include mechanisms to ensure consistency in those areas. Federal internal control standards require that federal agencies design control activities to achieve objectives and respond to risks, and that agencies implement control activities, including documenting the responsibilities for these activities through policies and procedures.³⁴ Without standard procedures for monitoring demonstration spending and documenting those efforts, CMS faces the risk of continued inconsistencies in monitoring and the risk that it may not identify cases where states may be inappropriately using federal funds or exceeding spending limits.

CMS Is Implementing a Revised Policy for Applying Spending Limits, but the Extent to Which It Will Effectively Control Costs Is Unclear

CMS's policy for applying demonstration spending limits has allowed our selected states to accrue unused spending authority under the demonstration spending limit (referred to in this report as unspent funds) and use it to expand demonstrations to include new costs. According to CMS officials, under long-standing policy, if a state spends less than the spending limit, the agency allows the state to accrue the difference between actual expenditures and the spending limit and carry forward the unspent funds into future demonstration periods.³⁵ CMS allowed our selected states to use unspent funds to expand the demonstration by, for example, financing care for additional eligibility groups or additional supplemental payments. For example, according to CMS officials, Indiana accrued \$600 million in unspent state and federal funds during the first demonstration period and was using a portion of that—approximately \$2 million a year—to finance care for a small group of beneficiaries with end-

³⁴GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

³⁵The policy on accrued unspent funds is part of CMS's budget neutrality policy, which was not formally documented, but has been in place for many years.

stage renal disease in a subsequent period of the demonstration.³⁶ CMS allowed New York to use \$8 billion in accrued unspent federal funds from previous demonstration periods to expand its demonstration by including a new supplemental payment pool for incentive payments to Medicaid providers, costs that would not have been eligible for federal matching funds outside of the demonstration.³⁷ If a state were to exceed its spending limit in a demonstration period, the agency allows it to draw upon unspent funds from previous demonstration periods to cover demonstration expenses, which, according to CMS officials, is consistent with the budget neutrality policy, under which spending limits are enforced over the life of the demonstration including any extensions beyond the initial 5-year term.

The flexibility afforded to states in their accrual and use of unspent funds may explain, in part, why CMS has infrequently found that states exceed spending limits. Agency officials told us the agency has only withheld federal funds once as a result of a state exceeding its spending limit.³⁸ Specifically, in 2007, CMS found that Wisconsin exceeded its demonstration spending limit and required the state to return \$10.2 million to the federal government.

Among our selected states, we found that states could accrue significant amounts of unspent funds. For example, CMS officials estimated that New York and California accrued billions of dollars in unspent funds. Based on our analysis, we found that Tennessee accrued approximately \$11.6 billion in unspent funds over 3 years. (See fig. 4) According to CMS officials, growth in health care costs has proven lower than the agency and states assumed when setting the spending limits, resulting in spending that consistently falls below spending limits across

³⁶The demonstration provides individuals with incomes between 150 and 300 percent of the federal poverty level—who would otherwise be ineligible for Medicaid—with Medicaid coverage to supplement their Medicare coverage for end-stage renal disease.

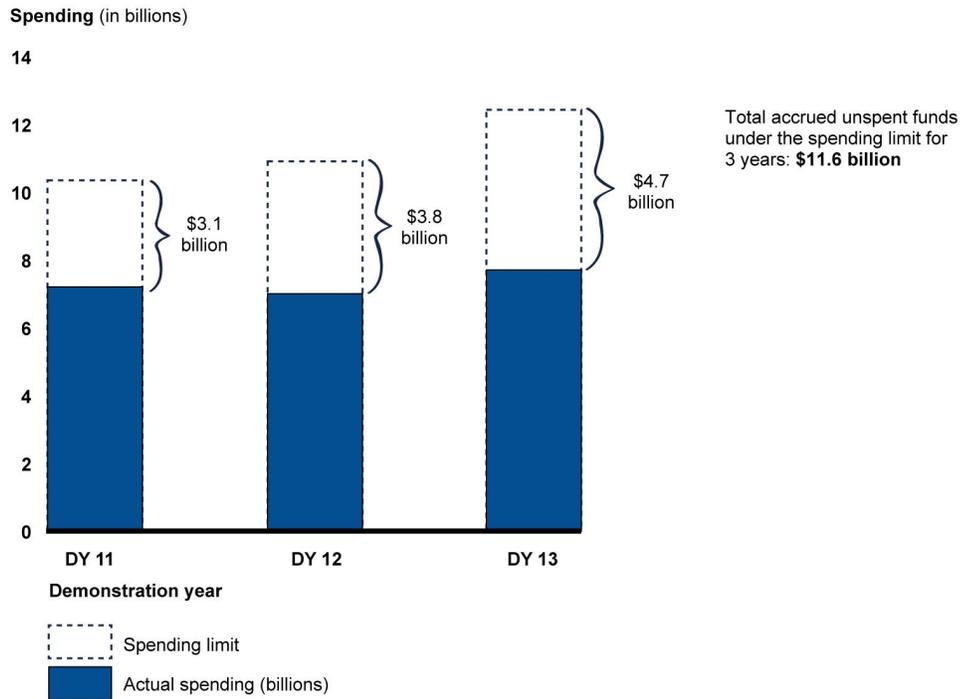
³⁷Given New York's challenges in reporting expenditures, CMS has not been able to determine a specific dollar amount of accrued unspent funds, but CMS officials told us they estimated them to be in the tens of billions of dollars, and thus, approving an \$8 billion pool was not likely to exceed the spending limit.

³⁸CMS allowed 12 states to request an increase of their spending limits without going through the formal amendment process when costs proved higher than the state projected. Specifically, states with demonstrations that affected services for individuals newly eligible for Medicaid under PPACA were granted this flexibility because they lacked the data necessary for developing their cost projections. As of December 2016, CMS has approved increased spending limits for two states, Arkansas and Michigan.

demonstrations. In past work, we found that HHS had approved spending limits that were higher than the budget neutrality policy suggested. Among other concerns, we reported that HHS allows methods for establishing the spending limit that may be inappropriate—including application of inappropriately high growth rates—and may result in excessively high spending limits. For example, we found four demonstrations where the spending limits were a total of \$32 billion higher than they should have been for the demonstration periods, typically 5 years.³⁹

³⁹As a result of these findings as well as findings from 2008, GAO made recommendations to CMS to improve the budget neutrality policy and reexamine spending limits. Specifically, we recommended that CMS reconsider its approved spending limits for demonstrations in various states including Arizona, Florida, and Texas. CMS disagreed with our recommendations. See GAO, *Medicaid Demonstration Waivers: Recent HHS Approvals Continue to Raise Cost and Oversight Concerns*, [GAO-08-87](#) (Washington, D.C.: Jan. 31, 2008); and *Medicaid Demonstration Waivers: Approval Process Raises Cost Concerns and Lacks Transparency*, [GAO-13-384](#) (Washington, D.C.: June 25, 2013).

Figure 4: Comparison of Tennessee’s Actual Expenditures to Spending Limit, Demonstration Years 11-13



Source: GAO analysis of Centers for Medicare & Medicaid Services demonstration expenditures data, as of October 3, 2016. | GAO-17-312

Note: This demonstration was initially approved in 2002. Demonstration years 11 through 13 cover July 1, 2012, through June 30, 2015. Unspent funds refer to unused spending authority under the demonstration.

In May 2016, CMS communicated to states that the budget neutrality policy had been revised to, among other things, restrict the accrual of unspent funds to better control demonstration costs.⁴⁰ Specifically, for demonstrations renewed starting in January 2016, CMS restricts the amount of unspent funds states can accrue over time in two ways. First, when states apply to renew their demonstrations, they can only carry over unspent funds from the past 5 years of the demonstration. Second, for demonstrations renewed through 2021, CMS limits the amount of unspent funds states can accrue each year in the renewal period. Specifically, after a state’s initial 5-year demonstration period, the amount of expected unspent funds that a state can accrue is reduced by 10 percent per year,

⁴⁰CMS’s revised policy also includes additional provisions that are not related to accrued unspent funds under the spending limit.

until states can only accrue 25 percent of expected unspent funds under the spending limit.⁴¹ For example, a state renewing its demonstration after completing its first 5-year demonstration period would be able to keep 90 percent of the unspent funds it would accrue under the spending limit in the sixth year of the demonstration—which is the first year of the renewal period—80 percent in the seventh year, and so on. States that had renewed previously would experience further restrictions until the 13th year of the demonstration, at which point a state would be limited to accruing 25 percent a year.

For demonstration renewals starting in 2021, states will still be limited to carrying over 5 years of unspent funds, but the percentage restrictions will be replaced with different requirements that could lower spending limits. Specifically, CMS will require states to submit new cost estimates using recent cost data (i.e., to rebase their cost projections). Those new cost projections, subject to adjustment, would become the basis of spending limits for the renewal period. To the extent that using more recent cost data results in spending limits that more closely reflect actual costs—which have proven lower than assumed by states and CMS when setting the spending limit—this requirement may lower spending limits and accordingly may reduce the unspent funds that states accrue under those limits.

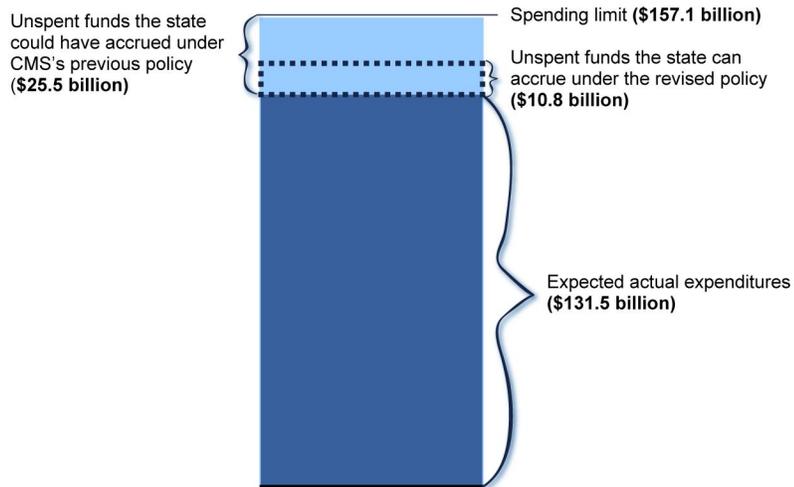
As of mid-December 2016, CMS was in the early stages of implementing the restrictions, having approved six demonstration renewals under the revised policy—those for Arizona, California, Massachusetts, New York, Tennessee, and Vermont.⁴² The updated STCs for the new demonstration periods in each state limited the states' access to unspent funds to the last 5 years and reduced the amount of unspent funds the states can accrue over the next 5 years. For example, under the revised policy,

⁴¹CMS will reduce expected unspent funds for demonstrations starting in their sixth year but only for on-going activities. For example, if a state expands its demonstration to cover an additional eligibility group, any unspent funds for that group will not be reduced during the first 5 years of coverage for that group. When determining whether an activity is new or ongoing, CMS will also consider whether a program activity was in place under another Medicaid authority prior to being incorporated in the demonstration.

⁴²In comments on a draft copy of this report, CMS noted that the agency also applied the new restrictions in renewing demonstrations in Indiana and Maryland. From our review of the related STCs, it was unclear how the restrictions were applied for those two demonstrations.

California’s expected accrued unspent funds over its next demonstration period will be reduced by approximately \$15 billion.⁴³ (See fig. 5.)

Figure 5: Expected Actual Expenditures and Accrued Unspent Funds for California, Demonstration Period 2016-2020



Source: GAO summary of Centers for Medicare & Medicaid Services documentation of estimated future expenditures for California. | GAO-17-312

Note: Numbers may not total due to rounding. Unspent funds refer to unused spending authority under the demonstration.

The effectiveness of the revised policy in controlling costs will depend, in part, on whether CMS consistently implements the revisions. We found two weaknesses that could lead to inconsistent application.

- Lack of formal guidance.** CMS released a slide presentation on the revised policy during a teleconference with all states but has not issued formal guidance. CMS made the slides available on the agency’s website, but they were not included in the database of guidance—typically letters—for state Medicaid directors. CMS officials

⁴³CMS expects that California will accrue a total of \$10.8 billion over the next demonstration period (which runs from 2016 through 2020) as compared to the \$25.5 billion the state would have accrued in unspent funds under the previous policy. Similarly, Arizona will likely accrue fewer unspent funds in its next demonstration period. The state is limited to 25 percent of its expected unspent funds. However, we previously reported that the spending limit set for Arizona’s demonstration for the period of 2011 through 2016 was about \$26 billion higher than it should have been, in part because it was not based on recent spending data. See [GAO-13-384](#). Therefore, it is likely that the state will still accrue billions of dollars in unspent funds during the new demonstration period and will carry over billions in accrued unspent funds from the past period.

told us that there was no plan to issue additional guidance to states.⁴⁴ Although the slides detail how unspent funds will be reduced, without formal guidance, it is unclear whether CMS will consistently apply these new requirements during demonstration renewals.

- **Inconsistent tracking of unspent funds.** We found that CMS was not consistently tracking unspent funds under the spending limits in our selected states, which makes it difficult for CMS to ensure the unspent funds are reduced by the amount specified under the new policy. For example, New York had not provided the financial reporting CMS needed to calculate the state's actual costs for the different eligibility groups covered by the demonstration or its accrued unspent funds, even though there were specific spending limits for these different groups. As a result, CMS could not track unspent funds in the state. CMS officials told us the agency required New York to produce that information as part of the application for renewing the state's demonstration.⁴⁵ Similarly, the agency did not have actual costs for California's demonstration, given California's lack of reporting as specified under the STCs, and required the state to provide that information under its renewed demonstration.⁴⁶ CMS officials told us the standard operating procedures, as noted above, that the agency is developing for monitoring demonstrations will reflect the revisions to CMS's budget neutrality policy. It is too soon to determine if these procedures will ensure consistent tracking of unspent funds because, as we noted earlier, there was no documentation of the agency's plans for these procedures as of December 2016.

Federal internal control standards require that federal agencies should design control activities to achieve objectives.⁴⁷ Control activities like formal guidance and standard procedures that clarify the application of

⁴⁴CMS officials told us that they communicated this policy change through a slideshow presentation provided during a May 2016 call with states to allow the agency to move quickly in implementing the policy.

⁴⁵In addition, according to CMS officials, the agency also required New York to develop a plan to correct reporting problems, including completing a budget neutrality specifications manual to provide guidance to the state on how to pull the data needed to report on budget neutrality.

⁴⁶CMS officials told us that California may not carry forward any accrued unspent funds from the last 5 years until the state provides CMS with a certified and audited final assessment of budget neutrality, including actual expenditures, for that period.

⁴⁷[GAO-14-704G](#).

agency policies help ensure that those policies—such as the revised budget neutrality policy—are consistently carried out in achieving cost control objectives. Without addressing potential weaknesses, including the lack of formal guidance and the lack of consistent tracking of unspent funds across all demonstrations, CMS may not be able to effectively implement the policy and achieve its related cost-control objectives.

Conclusions

Medicaid section 1115 demonstrations are an important tool for states to test new approaches to delivering care that, among other things, may be more cost effective. However, the growing federal expenditures for demonstrations—now at over \$100 billion a year—for costs that, in some cases, would not otherwise be eligible for Medicaid funding makes monitoring of those dollars critical. While our work found that CMS was monitoring demonstration spending in our selected states, the agency's process also raised concerns. CMS's lack of standard procedures for its monitoring process has contributed to insufficient reporting requirements for states and inconsistent enforcement of those requirements. Insufficient reporting can create a barrier to monitoring efforts, including assessing compliance with spending limits. Inconsistent enforcement might allow compliance issues to go undetected for extended periods of time, which, as demonstrated by the issues in California and New York, can take years to resolve.

A key principle for demonstrations has long been the policy that they must be budget neutral to the federal government. Whether demonstrations adhere to that principle depends both on how CMS approves and applies spending limits during the demonstration. We have raised concerns in the past about demonstration approvals, including that in some cases spending limits for demonstrations were set too high. Our current work found that as a result of high spending limits, states are accruing significant amounts of unspent funds under the spending limits and using those funds to finance expansions of the demonstration. CMS's move under the revised budget neutrality policy to begin restricting the amount of unspent funds that states can accrue is a positive step toward the agency's goal of better controlling demonstration costs. However, states may continue to accrue significant amounts of unspent funds. Without standard procedures for tracking these funds, CMS will not be able to effectively enforce the limits on those funds. Further, without formal guidance on the revised policy, it is unclear whether CMS will consistently apply the policy.

Recommendations for Executive Action

To improve consistency in CMS oversight of federal spending under section 1115 demonstrations, we recommend that the Secretary of Health and Human Services require the Administrator of CMS to take the following two actions:

1. Develop and document standard operating procedures for monitoring spending under demonstrations that
 - a. Require setting reporting requirements for states that provide CMS the data elements needed for CMS to assess compliance with demonstration spending limits;
 - b. Require consistent enforcement of states' compliance with financial reporting requirements; and
 - c. Require consistent tracking of the amount of unspent funds under demonstration spending limits.
2. Issue formal guidance on the revised budget neutrality policy, including information on how the policy will be applied.

Agency Comments and Our Evaluation

We provided a draft of this report to HHS for review and comment. HHS concurred with our first recommendation that the agency should develop and document standard operating procedures for monitoring demonstration spending. In its response to this recommendation, HHS added that the department is developing infrastructure and procedures to better support demonstration monitoring. HHS did not explicitly agree or disagree with the second recommendation that the agency should issue formal guidance on the revised budget neutrality policy and how it will be applied. In its response to this recommendation, HHS noted that the new policy is being incorporated into new budget neutrality workbook templates and monitoring procedures, which will be used by the states and reviewers. The agency stated that it will determine if additional guidance is needed as implementation continues. Given the importance of this policy in controlling demonstration costs, we believe that developing formal guidance is necessary to ensure consistent application.

HHS also provided technical comments, which we incorporated as appropriate. HHS's comments are reprinted in appendix II.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Secretary of Health and Human Services, appropriate congressional committees, and other interested parties. The report is also available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions about this report, please contact me at (202) 512-7114 or iritanik@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.

Sincerely yours,

A handwritten signature in black ink that reads "Katherine Iritani". The signature is written in a cursive, flowing style.

Katherine M. Iritani
Director, Health Care

Appendix I: Federal Spending for Medicaid
Section 1115 Demonstrations, by State,
Federal Fiscal Years 2005 and 2015

Appendix I: Federal Spending for Medicaid Section 1115 Demonstrations, by State, Federal Fiscal Years 2005 and 2015

State	2005			2015		
	Total Medicaid expenditures (millions)	Expenditures for demonstrations (millions)	Percent of Medicaid spending for demonstrations	Total Medicaid expenditures (millions)	Expenditures for demonstrations (millions)	Percent of Medicaid spending for demonstrations
Alabama	3,277.5	22.1	0.7	3,663.3	28.5	0.8
Alaska	765.7	0.0	0.0	825.7	0.0	0.0
Arizona	4,759.9	3,438.9	72.2	7,896.9	7,874.7	99.7
Arkansas	2,530.0	46.5	1.8	4,301.9	1,460.1	33.9
California	20,455.7	531.4	2.6	53,209.2	29,272.4	55.0
Colorado	1,686.9	117.8	7.0	4,420.0	0.2	0.0
Connecticut	2,427.0	0.0	0.0	4,211.2	0.0	0.0
Delaware	527.9	274.2	51.9	1,115.3	986.0	88.4
District of Columbia	1,056.1	7.6	0.7	1,758.7	69.6	4.0
Florida	9,378.8	58.7	0.6	12,877.1	8,109.1	63.0
Georgia	5,295.2	0.0	0.0	6,526.1	3.8	0.1
Hawaii	727.8	284.5	39.1	1,258.5	1,176.1	93.5
Idaho	859.0	0.0	0.0	1,234.3	0.0	0.0
Illinois	6,506.1	1,220.0	18.8	10,182.5	13.4	0.1
Indiana	3,957.3	0.0	0.0	6,365.8	1,581.1	24.8
Iowa	1,821.5	0.0	0.0	2,859.2	110.9	3.9
Kansas	1,444.8	0.0	0.0	1,713.7	1,606.5	93.7
Kentucky	3,569.9	536.7	15.0	7,505.7	0.0	0.0
Louisiana	4,544.5	0.0	0.0	4,923.3	592.4	12.0
Maine	1,752.6	101.5	5.8	1,549.2	31.7	2.0
Maryland	3,103.4	1,658.8	53.5	5,631.7	4,251.3	75.5
Massachusetts	5,747.9	3,100.5	53.9	8,631.8	5,642.8	65.4
Michigan	5,919.3	0.0	0.0	11,538.0	4,081.6	35.4
Minnesota	3,344.8	153.8	4.6	6,275.2	96.3	1.5

**Appendix I: Federal Spending for Medicaid
Section 1115 Demonstrations, by State,
Federal Fiscal Years 2005 and 2015**

State	2005			2015		
	Total Medicaid expenditures (millions)	Expenditures for demonstrations (millions)	Percent of Medicaid spending for demonstrations	Total Medicaid expenditures (millions)	Expenditures for demonstrations (millions)	Percent of Medicaid spending for demonstrations
Mississippi	3,101.2	5.5	0.2	3,806.7	78.1	2.1
Missouri	4,815.9	32.3	0.7	6,099.3	451.4	7.4
Montana	611.8	52.0	8.5	766.7	49.6	6.5
Nebraska	990.6	0.0	0.0	990.2	0.0	0.0
Nevada	800.4	0.0	0.0	2,341.0	215.5	9.2
New Hampshire	749.2	0.0	0.0	1,011.0	0.0	0.0
New Jersey	4,514.8	8.3	0.2	8,631.5	7,368.5	85.4
New Mexico	2,135.5	3.5	0.2	3,897.8	3,613.4	92.7
New York	25,774.5	10,287.1	39.9	31,757.3	880.4	2.8
North Carolina	6,793.0	0.0	0.0	8,742.7	1.3	0.0
North Dakota	416.8	0.0	0.0	666.3	0.0	0.0
Ohio	8,321.1	0.0	0.0	14,787.0	0.0	0.0
Oklahoma	2,313.7	935.0	40.4	2,987.2	1,505.1	50.4
Oregon	2,098.6	1,321.6	63.0	6,251.3	4,179.6	66.9
Pennsylvania	10,269.3	0.0	0.0	12,977.9	629.6	4.9
Rhode Island	1,114.0	140.2	12.6	1,530.4	991.6	64.8
South Carolina	3,432.8	699.3	20.4	4,082.6	0.0	0.0
South Dakota	502.2	0.0	0.0	452.0	0.0	0.0
Tennessee	5,895.1	2,760.6	46.8	5,916.7	4,867.1	82.3
Texas	12,669.4	0.0	0.0	20,430.3	15,898.4	77.8
Utah	1,167.0	253.0	21.7	1,522.7	131.6	8.6
Vermont	622.9	252.1	40.5	986.7	974.0	98.7
Virginia	2,669.7	1.0	0.0	4,070.1	4.0	0.1
Washington	3,468.1	38.8	1.1	6,817.9	0.7	0.0
West Virginia	1,942.2	0.0	0.0	2,801.3	0.0	0.0
Wisconsin	3,349.1	162.8	4.9	4,644.3	578.3	12.5
Wyoming	285.4	0.0	0.0	285.3	0.0	0.0
National total	206,283.6	28,506.1	13.8	329,728.6	109,406.9	33.2

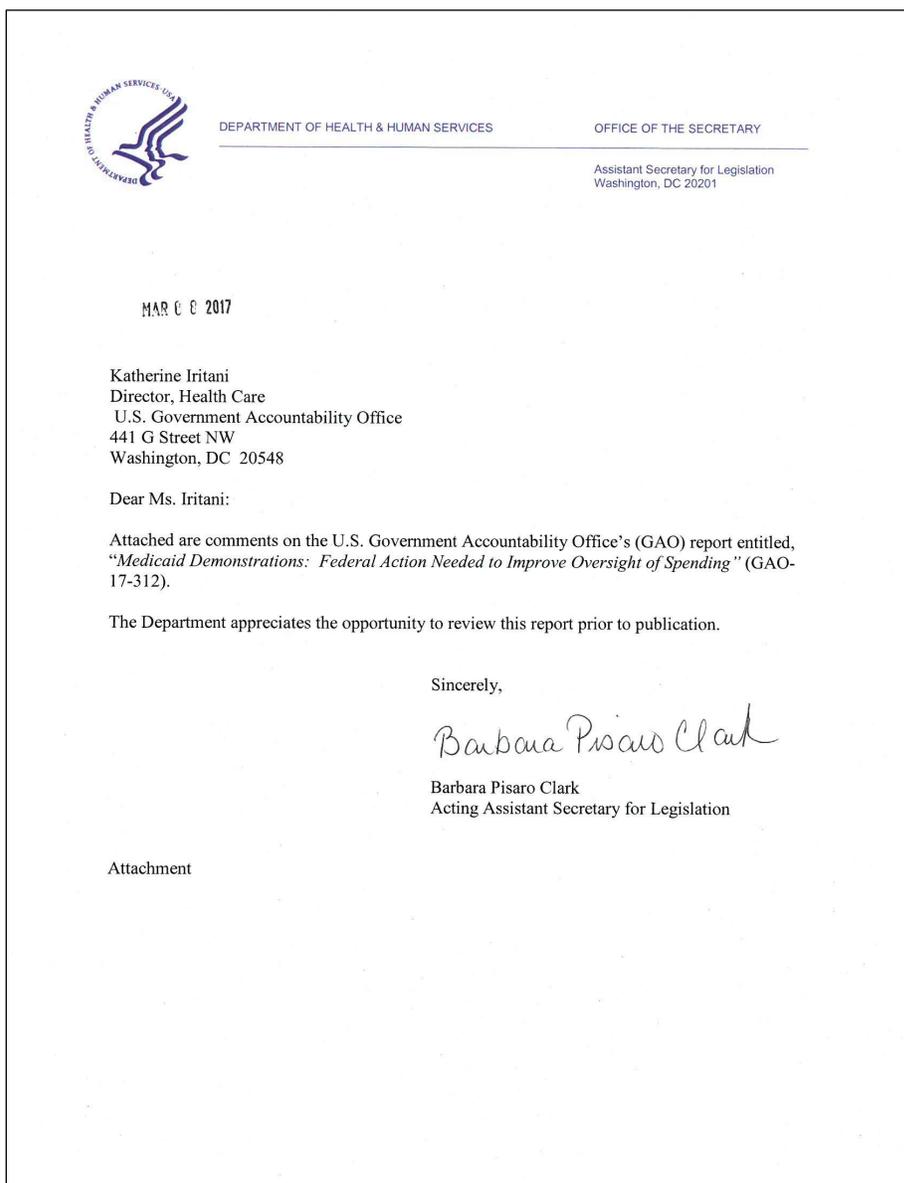
Source: GAO analysis of Centers for Medicare & Medicaid Services data, as of October 3, 2016. | GAO-17-312

Note: Total Medicaid expenditures reflect federal spending and do not include state spending. We included data on medical spending and excluded administrative costs. States have 2 years to report spending; therefore, states may have reported expenditures for a given fiscal year even if the state did not have an active demonstration that year. The data reflect adjustments to prior years of spending, both positive and negative; therefore, the data may overstate or understate spending in the

**Appendix I: Federal Spending for Medicaid
Section 1115 Demonstrations, by State,
Federal Fiscal Years 2005 and 2015**

given years. Data for New York for fiscal year 2015 likely understates total spending as the state's expenditure reporting for that year was incomplete.

Appendix II: Comments from the Department of Health and Human Services



GENERAL COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES (HHS) ON THE GOVERNMENT ACCOUNTABILITY OFFICE'S DRAFT REPORT ENTITLED: MEDICAID DEMONSTRATIONS: FEDERAL ACTION NEEDED TO IMPROVE OVERSIGHT OF SPENDING (GAO-17-312)

The Department of Health and Human Services (HHS) appreciates the opportunity to review and comment on the Government Accountability Office's (GAO) draft report on Medicaid Section 1115 demonstrations. HHS takes seriously its role in oversight of Section 1115 demonstrations.

Section 1115 of the Social Security Act gives the Secretary of HHS authority to approve experimental, pilot, or demonstration projects that promote the objectives of Medicaid and the Children's Health Insurance Program (CHIP). These demonstrations give states additional flexibility to design and evaluate innovative policy approaches to improve their Medicaid programs and use innovative service delivery systems that improve care, increase efficiency, and reduce costs.

HHS uses a range of approaches to exercise its responsibility for oversight of Section 1115 demonstration spending. It begins with providing technical support to states in their demonstration design and developing the special terms and conditions (STCs). These provide many of the guardrails within which the demonstration must be conducted and financed, as well as spending limits to ensure budget neutrality. In order for 1115 demonstrations to be budget neutral to the federal government, the state must illustrate how the projected federal expenditures under the demonstration will not exceed what the federal government would have spent in the Medicaid program, absent the demonstration.

HHS oversight involves ongoing assessment of compliance with the demonstration's STCs, for example, through monthly monitoring calls and review of quarterly and annual reports submitted by states. HHS also oversees state-specific spending limits under budget neutrality, based on spending reports states submit with their required quarterly and annual reports, and on the states' CMS-64 Quarterly Expense Reports. HHS works with states to address any questions or concerns and to obtain additional information as needed.

As part of its oversight, HHS ensures that the state does not exceed its demonstration spending limit. The flexibilities afforded to states under section 1115 demonstrations may generate savings from successful implementation of program efficiencies. Section 1115 demonstration savings are not expenditures or funds paid to the state. Savings states realize when actual 1115 costs are lower than the demonstration's defined spending limit are actually unused spending authority that states can utilize to implement new initiatives to the extent they are approved under the demonstration. Most of the 1115 savings that states have realized are cost savings from testing new approaches to operating routine Medicaid program authorities, like managed care and home and community based services, under section 1115 authority. It is important to note that this does not imply that all or even most of these expenditures would be unallowable outside of the demonstrations.

To further improve upon the oversight of demonstration spending, HHS implemented a revised budget neutrality policy in May 2016 as is pointed out in the draft report. The revised budget neutrality methodologies are designed to better align demonstration spending limits with current health care environments in the state while also maintaining support for state flexibility to

GENERAL COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES (HHS) ON THE GOVERNMENT ACCOUNTABILITY OFFICE'S DRAFT REPORT ENTITLED: MEDICAID DEMONSTRATIONS: FEDERAL ACTION NEEDED TO IMPROVE OVERSIGHT OF SPENDING (GAO-17-312)

innovate in the Medicaid program through section 1115 authority. HHS is working with states on adjusting demonstration spending limits as states apply for renewal of their 1115 program.

HHS is also building infrastructure to better support the monitoring process for 1115 demonstrations. This includes the development of standardized reporting templates and reporting metrics, the creation of IT information management tools, and a standard operating procedure to support monitoring activities. The first iteration of these tools and processes is scheduled to be rolled out for testing in the summer of 2017.

GAO's recommendations and HHS' responses are below.

GAO Recommendation

Develop and document standard operating procedures for monitoring spending under demonstrations that:

- a. Require setting reporting requirements for states that provide CMS the data elements needed for CMS to assess compliance with demonstration spending limits;
- b. Require consistent enforcement of states' compliance with financial reporting requirements; and
- c. Require consistent tracking of the amount of unspent funds under demonstration spending limits.

HHS Response

HHS concurs with GAO's recommendation. HHS is currently developing infrastructure and procedures to better support monitoring under demonstrations.

GAO Recommendation

Issue formal guidance on the revised budget neutrality policy, including information on how the policy will be applied.

HHS Response

HHS has informed states of the revised policy and continues to work with states, as needed, on any assistance states may need. HHS began implementing the new policy at the beginning of 2016 with demonstration renewals and new demonstrations, and the policy is now operating in a significant number of states and described publicly in their respective demonstration terms and conditions. HHS continues to provide technical assistance to states on the new policy, as necessary, through webinars, technical assistance guides, and calls with project officers. Also, as HHS finalizes new budget neutrality workbook templates and monitoring procedures, the new budget neutrality policy is being incorporated for use by the state and reviewers. As implementation continues, HHS will determine if additional guidance is needed.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Katherine M. Iritani, (202) 512-7114 or iritanik@gao.gov

Staff Acknowledgments

In addition to the contact named above, Susan Barnidge (Assistant Director), Jasleen Modi (Analyst-in-Charge), Shamonda Braithwaite, Elizabeth Miller, and Giao N. Nguyen made key contributions to this report. Also contributing were Giselle Hicks, Laurie Pachter, and Emily Wilson.

Appendix IV: Accessible Data

Data Tables

Data table for Highlights figure, Federal Expenditures under Medicaid Section 1115 Demonstrations, Fiscal Years 2005, 2010, and 2015

Year	2005	2010	2015
Expenditures (in billions)	29	49	109
Demonstrations as share of total Medicaid expenditures	14	17	33

Data Table for Figure 2: Federal Expenditures under Medicaid Section 1115 Demonstrations, Fiscal Years 2005, 2010, and 2015

Year	2005	2010	2015
Expenditures (in billions)	29	49	109
Demonstrations as share of total Medicaid expenditures	14	17	33

Data Table for Figure 4: Comparison of Tennessee’s Actual Expenditures to Spending Limit, Demonstration Years 11-13

Demonstration Year	Spending limit (billions)	Actual spending (billions)
DY 11	10.3	7.2
DY 12	10.8	7.0
DY 13	12.4	7.7

Data Table for Figure 5: Expected Actual Expenditures and Accrued Unspent Funds for California, Demonstration Period 2016-2020

- Demonstration Spending (in billions) =157
- Unspent funds under previous policy = 25.5
- Unspent funds under the revised policy = 10.8

Agency Comment Letter

Text of Appendix II: Comments from the Department of Health and Human Services

Page 1

Katherine Iritani Director, Health Care

U.S. Government Accountability Office 441 G Street NW

Washington , DC 20548

Dear Ms. Iritani:

Attached are comments on the U.S. Government Accountability Office's (GAO) report entitled, "Medicaid Demonstrations: Federal Action Needed to Improve Oversight of Spending " (GAO- 17-312).

The Department appreciates the opportunity to review this report prior to publication.

Sincerely,

Barbara Pisaro Clark

Acting Assistant Secretary for Legislation

Attachment

Page 2

GENERAL COMMENTS OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES (HHS) ON THE GOVERNMENT ACCOUNTABILITY OFFICE'S DRAFT REPORT ENTITLED: MEDICAID DEMONSTRATIONS: FEDERAL ACTION NEEDED TO IMPROVE OVERSIGHT OF SPENDING (GAO-17-312)

The Department of Health and Human Services (HHS) appreciates the opportunity to review and comment on the Government Accountability

Office's (GAO) draft report on Medicaid Section 1115 demonstrations. HHS takes seriously its role in oversight of Section 1115 demonstrations.

Section 1115 of the Social Security Act gives the Secretary of HHS authority to approve experimental, pilot, or demonstration projects that promote the objectives of Medicaid and the Children's Health Insurance Program (CHIP). These demonstrations give states additional flexibility to design and evaluate innovative policy approaches to improve their Medicaid programs and use innovative service delivery systems that improve care, increase efficiency, and reduce costs.

HHS uses a range of approaches to exercise its responsibility for oversight of Section 1115 demonstration spending. It begins with providing technical support to states in their demonstration design and developing the special terms and conditions (STCs). These provide many of the guardrails within which the demonstration must be conducted and financed, as well as spending limits to ensure budget neutrality. In order for 1115 demonstrations to be budget neutral to the federal government, the state must illustrate how the projected federal expenditures under the demonstration will not exceed what the federal government would have spent in the Medicaid program, absent the demonstration.

HHS oversight involves ongoing assessment of compliance with the demonstration's STCs, for example, through monthly monitoring calls and review of quarterly and annual reports submitted by states. HHS also oversees state-specific spending limits under budget neutrality, based on spending reports states submit with their required quarterly and annual reports, and on the states' CMS-64 Quarterly Expense Reports. HHS works with states to address any questions or concerns and to obtain additional information as needed.

As part of its oversight, HHS ensures that the state does not exceed its demonstration spending limit. The flexibilities afforded to states under section 1115 demonstrations may generate savings from successful implementation of program efficiencies. Section 1115 demonstration savings are not expenditures or funds paid to the state. Savings states realize when actual 1115 costs are lower than the demonstration's defined spending limit are actually unused spending authority that states can utilize to implement new initiatives to the extent they are approved under the demonstration. Most of the 1115 savings that states have realized are cost savings from testing new approaches to operating routine Medicaid program authorities, like managed care and home and community based

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Page 3

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