

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**THE CENTERS FOR  
MEDICARE & MEDICAID  
SERVICES' REVIEW CONTRACTOR  
DID NOT DOCUMENT MEDICAID  
MANAGED CARE PAYMENT  
REVIEW DETERMINATIONS MADE  
UNDER THE PAYMENT ERROR  
RATE MEASUREMENT PROGRAM**

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# ***Office of Inspector General***

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## Report in Brief

Date: December 2022

Report No. A-04-21-09003

U.S. DEPARTMENT OF HEALTH & HUMAN SERVICES  
**OFFICE OF INSPECTOR GENERAL**



### Why OIG Did This Audit

The Centers for Medicare & Medicaid Services (CMS) is responsible for overseeing States' design and operation of their Medicaid programs and ensuring that Federal funds are appropriately spent. CMS developed the Payment Error Rate Measurement (PERM) program to measure improper payments in Medicaid and the Children's Health Insurance Program (CHIP). This is the third in a series of three OIG audits that assessed the adequacy of the PERM program by reviewing the accuracy of determinations for each of its three components.

The objective of this audit was to assess the adequacy of the PERM program by determining whether CMS's contractor conducted Medicaid Managed Care (MMC) payment reviews that were in accordance with Federal requirements.

### How OIG Did This Audit

Our audit covered 407 PERM MMC payments reviewed by CMS's PERM contractor, totaling \$476,065 (\$291,356 Federal share), included in the MMC component of the Reporting Year (RY) 2019 PERM program for 3 States. We judgmentally selected these States based on the total amount of the MMC payments and the number of MMC payments reviewed by CMS's review contractor. We reviewed a random sample of 100 PERM MMC payments for the 3 States.

## The Centers for Medicare & Medicaid Services' Review Contractor Did Not Document Medicaid Managed Care Payment Review Determinations Made Under the Payment Error Rate Measurement Program

### What OIG Found

CMS's review contractor conducted the majority of its MMC payment reviews in accordance with Federal requirements. Of the 100 sampled MMC payments we reviewed, 60 were correctly determined. However, we were not able to determine whether the remaining 40 payment review determinations were correct because the payment reviews were not documented and therefore may be incorrect. Based on the sample results, we estimated 40 percent of the sampled MMC payment determinations made by CMS's review contractor may not have been correct. We also estimated the total amount related to these 40 claims to be \$229,435 (\$123,520 Federal share) during our audit period.

CMS's review contractor did not maintain documentation of its payment review determinations because CMS did not include specific contract and statement of work language requiring its review contractor to maintain all documentation to support its MMC payment review determinations for non-errors.

We are not making recommendations because CMS took action to address the deficiencies we identified. Specifically, after our audit period, for RY 2020, 2021 and 2022 PERM cycles, CMS exercised an optional task for the contract with the review contractor, which added language requiring the review contractor to maintain relevant documentation for non-error (i.e., correct) payments. In its contract renewal occurring in March 2021, CMS replaced the optional task with a permanent requirement for the review contractor to maintain relevant documentation for non-error payments.

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## INTRODUCTION

### WHY WE DID THIS AUDIT

The Centers for Medicare & Medicaid Services (CMS) is responsible for overseeing States' design and operation of their Medicaid programs and ensuring that Federal funds are appropriately spent. CMS developed the Payment Error Rate Measurement (PERM) program to measure improper payments in Medicaid and the Children's Health Insurance Program (CHIP) and produce error rates for each program based on reviews of the fee-for-service (FFS), Medicaid managed care (MMC), and eligibility components of Medicaid and CHIP in the year under review. CMS recently made substantive changes to its PERM program to incorporate changes mandated by the Affordable Care Act.<sup>1</sup> CMS used a PERM MMC review contractor to perform PERM MMC reviews. This is the third in a series of three OIG audits<sup>2</sup> that assessed the adequacy of the PERM program by reviewing the accuracy of determinations for each of its three components.<sup>3</sup>

### OBJECTIVE

The objective of this audit was to assess the adequacy of the PERM program by determining whether CMS's contractor conducted MMC payment reviews in accordance with Federal requirements.

### BACKGROUND

#### Medicaid Program

The Medicaid program provides medical assistance to low-income individuals and individuals with disabilities. To participate in Medicaid, States must cover certain population groups. The Federal and State Governments jointly fund and administer the Medicaid program.

States operate and fund Medicaid in partnership with the Federal Government through CMS. CMS reimburses States for a specified percentage of program expenditures, called the Federal

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<sup>1</sup> The Patient Protection and Affordable Care Act, P.L. No. 111-148 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, P.L. No. 111-152 (Mar. 30, 2010), is known as the Affordable Care Act.

<sup>2</sup> The first audit, *The Centers for Medicare & Medicaid Services' Eligibility Review Contractor Adequately Determined Medicaid Eligibility for Selected States Under the Payment Error Rate Measurement Program (A-02-20-01006)*, was issued March 2, 2022. The second audit, *The Centers for Medicare & Medicaid Services' Review Contractors Generally Conducted Medicaid Fee-for-Service Claim Reviews for Selected States Under the Payment Error Rate Measurement Program in Accordance with Federal and State Requirements (A-04-21-00132)*, was issued November 17, 2022.

<sup>3</sup> Specifically, for this audit, we reviewed the MMC component of the PERM program. Other audits reviewed the FFS and eligibility components of the PERM program.

medical assistance percentage (FMAP)<sup>4</sup>, which is developed from criteria such as States' per capita income.<sup>5</sup> During our audit period, the FMAPs for our selected states ranged from 51 to 63 percent. States may offer Medicaid benefits on an FFS basis, through managed care, or both.

### **Medicaid Managed Care Programs**

MMC programs are intended to increase access to and improve the quality of health care for Medicaid beneficiaries. States contract with managed care organizations (MCOs) to make services available to enrolled Medicaid beneficiaries, usually in return for a predetermined periodic payment, known as a capitation payment.<sup>6</sup>

### **Medicaid Payment Error Rate Measurement Reviews**

The PERM program uses a 3-year rotational cycle to estimate a national Medicaid improper payment rate. Each cycle examines the Medicaid program of 17 States.<sup>7</sup> Cycle 1 covered Medicaid payments made from July 1, 2017, through June 30, 2018 (Reporting Year (RY) 2019), and included the following States: Arkansas, Connecticut, Delaware, Idaho, Illinois, Kansas, Michigan, Minnesota, Missouri, New Mexico, North Dakota, Ohio, Oklahoma, Pennsylvania, Virginia, Wisconsin, and Wyoming. For these reviews, CMS utilized: (1) a statistical contractor responsible for collecting and sampling FFS claims and MMC capitation payment data, as well as calculating Medicaid State and national improper payment rates; (2) a review contractor responsible for conducting State data processing (DP) and medical record reviews for the PERM program;<sup>8</sup> and (3) an eligibility review contractor responsible for conducting State eligibility reviews for the PERM program.

The MMC component of the PERM program measures errors that occur in the capitation payments that State Medicaid agencies make to MCOs on behalf of beneficiaries. The PERM program assesses whether any payments made to the MCOs were different than those amounts that the State agency is contractually required to pay and are approved by CMS. In

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<sup>4</sup> The Federal government pays its share of a State's medical assistance expenditures (Federal share) under Medicaid based on the FMAP, which varies depending on the State's relative per capita income as calculated by a defined formula (42 CFR § 433.10).

<sup>5</sup> Social Security Act (the Act) § 1905(b).

<sup>6</sup> A capitation payment is "a payment the State makes periodically to a contractor on behalf of each beneficiary enrolled under a contract and based on the actuarially sound capitation rate for the provision of services under the State plan. The State makes the payment regardless of whether the particular beneficiary receives services during the period covered by the payment" (42 CFR § 438.2).

<sup>7</sup> The PERM program examines the 50 States and the District of Columbia as part of its 3-year rotational cycle.

<sup>8</sup> During our audit period, CMS used two review contractors. One contractor performed data processing reviews and another contractor performed medical record reviews.

contrast to the FFS component, the MMC component of the PERM program neither includes a medical review of services delivered to enrollees, nor reviews of MCO records or data. Rather, the MMC component of PERM program is based on DP reviews by the review contractor.

CMS estimated that the MMC rolling national improper payment rate<sup>9</sup> under the PERM program for RY 2019 was 0.12 percent.<sup>10</sup> CMS estimated that the MMC error rates were zero percent for all three states we reviewed: Illinois, Ohio, and Pennsylvania.

After the conclusion of the contractors' PERM reviews, States must develop a corrective action plan to address any findings.

### **Medicaid Payment Error Rate Measurement Managed Care Reviews**

The review contractor is responsible for conducting DP reviews for the MMC component of the PERM program. Accordingly, they are responsible for researching, requesting, and collecting applicable Federal regulations under Title 42 of the Code of Federal Regulations, and State policies from States' publicly available websites.

All PERM MMC payments go through a DP review. After the review contractor receives the PERM MMC payment data from the statistical contractor, it schedules DP reviews with each of the selected States. The review contractor performs DP reviews on MMC payments to determine if the States accurately processed the associated capitation payments.

### **HOW WE CONDUCTED THIS AUDIT**

Our audit covered 407 PERM MMC payments totaling \$476,065 (\$291,356 Federal share), that were reviewed by CMS's review contractor and were included in the RY 2019 PERM program for three Cycle 1 States—Illinois, Ohio, and Pennsylvania.<sup>11</sup> We reviewed a random sample of 100 of these payments totaling \$120,664 (\$72,936 Federal share).

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

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<sup>9</sup> CMS calculates a rolling national improper payment rate, which combines the most current findings from the three prior measurement cycles, using information from all 50 states and the District of Columbia to produce the improper payment rate for the current FY. Each time the PERM program measures a group of 17 states, it drops from its calculation the previous findings for that group of states and adds the newest findings.

<sup>10</sup> 2019 Medicaid & CHIP Supplemental Improper Payment Data, issued November 2019.

<sup>11</sup> We judgmentally selected these States because they had the highest MMC Federal expenditures.



Appendix A contains the details of our audit scope and methodology.

## FINDINGS

CMS's review contractor conducted the majority of its MMC payment reviews in accordance with Federal requirements. Of the 100 sampled MMC payments we reviewed, 60 were correctly determined.<sup>12</sup> However, we were not able to determine whether the remaining 40 payment review determinations were correct because the payment reviews were not documented and therefore may be incorrect. Based on the sample results, we estimated 40 percent of the sampled MMC payment determinations made by CMS's review contractor may not have been correct. We also estimated the total amount related to these 40 claims to be \$229,435 (\$123,520 Federal share) during our audit period.<sup>13</sup>

CMS's review contractor did not maintain documentation of their payment review determinations because CMS did not include specific contract and statement of work language requiring its review contractor to maintain all documentation to support its MMC payment review determinations for non-errors. After our audit period, for RY 2020, 2021 and 2022 PERM cycles, CMS exercised an optional task for the contract with the review contractor, which added language requiring the review contractor to maintain relevant documentation for non-error (i.e., correct) payments. In its contract renewal occurring in March 2021, CMS replaced the optional task with a permanent requirement for the review contractor to maintain relevant documentation for non-error payments. Thus, CMS took actions to mitigate such errors going forward.

We are not making recommendations because CMS took action to address the deficiencies we identified.

## OTHER MATTERS

In a 2018 report, the Government Accountability Office (GAO) examined the extent to which the PERM accounted for program integrity risks in MMC, including CMS's and States' oversight.<sup>14</sup> GAO found that the PERM improper payment rate for MMC was significantly lower than the improper payment rate for FFS. However, GAO noted that this difference did not

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<sup>12</sup> The review contractor determined that all 100 MMC payments in our sample were non-errors. The review contractor did not document its payment review determinations for all 100 MMC payments; however, we were able to obtain documentation from the selected States to verify 60 of the payment review determinations. In accordance with our approved sampling plan, we treated the remaining 40 payments as errors (i.e., insufficient documentation to support the review contractor's findings).

<sup>13</sup> Appendix B describes our statistical sampling methodology and Appendix C contains our sample results and estimates.

<sup>14</sup> *CMS Should Take Steps to Mitigate Program Risks in Managed Care* ([GAO-18-291](#)), issued May 2018.

signal that better oversight existed for MMC; rather, it represented differences in the review criteria between FFS and MMC, which resulted in a less complete accounting for the program integrity risks in MMC. GAO explained that the PERM did not account for key program integrity risks in MMC: specifically, unidentified overpayments<sup>15</sup> and unallowable costs.<sup>16</sup> GAO concluded that CMS had taken steps to improve its oversight of MMC, yet these efforts fell short of ensuring that CMS and States would be able to identify and address MCO overpayments to providers and unallowable MCO costs.

GAO stated that, to the extent that States do not identify or know of MCO overpayments to providers or unallowable MCO costs, the overpayments and unallowable costs could inflate future capitation rates.<sup>17</sup> The PERM assesses the accuracy of capitation payments that States make to MCOs. States set capitation rates based on cost data—historical utilization and spending—that MCOs submit to the State Medicaid agencies, but the PERM does not consider these data. Unless removed from these cost data, unidentified overpayments and unallowable costs would likely inflate the MCO cost data that States use to set capitation rates. As a result, future capitation rates would also be inflated, resulting in higher State and Federal spending.

The GAO report added that, in fiscal year 2017, the MMC improper payment rate was 0.3 percent, while the FFS improper payment rate was 12.9 percent, leading to an assumption that the estimated risks in MMC are less significant than those estimated in FFS. However, the MMC component of the PERM does not determine whether MCO payments to providers were for services that were medically necessary, provided, accurately billed, and delivered by eligible providers, or whether the MCO costs were allowable and appropriate. As a result, GAO concluded that the PERM improper payment estimate potentially understates the extent of program integrity risks in MMC.

We share the concerns expressed by GAO in its report of MMC program risks and note that it is important to consider these issues when evaluating the effectiveness of CMS's and States' oversight of MMC.

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<sup>15</sup> Such overpayments included payments for services that were not provided or medically necessary; or to ineligible, excluded, or deceased providers, which are not measured by the PERM.

<sup>16</sup> Unallowable MCO costs refers to operating costs that MCOs cannot claim under their MMC contracts, such as certain marketing costs, or that the MCO reported incorrectly.

<sup>17</sup> Capitation payments do not directly relate to the provision of a specific service but reflect the average cost to provide covered services to enrollees.

## APPENDIX A: AUDIT SCOPE AND METHODOLOGY

### SCOPE

This audit covered 407 PERM MMC payments totaling \$476,065 (\$291,356 Federal share) that were included in the MMC review component of the RY 2019 PERM program for 3 Cycle 1 States—Illinois, Ohio, and Pennsylvania. We judgmentally selected these States because they had the highest MMC Federal expenditures. We reviewed a random sample of 100 PERM MMC payments totaling \$120,664 (\$72,936 Federal share).

We limited our review of internal controls to those applicable to our objective. Specifically, we tested controls to confirm that the MMC review contractor's policies and procedures for determining MMC allowability were operating as intended and reviewed supporting documentation to evaluate whether they determined MMC allowability in accordance with Federal.

### METHODOLOGY

To accomplish the objective for this audit, we:

- reviewed applicable Federal, regulations, and other requirements related to the PERM program;
- obtained documentation related to the review contractor's MMC payment reviews for Cycle 1 States;
- through questionnaires and email communications with CMS officials, obtained an understanding of the PERM program and recent changes made to the program;
- obtained from CMS and the statistical contractor, documentation which provided an understanding of the payment data submitted by States for the PERM program, the review contractor's quality review of those data, and the MMC review sampling process;
- obtained from CMS and review contractor DP review requirements and policies that the review contractor used in its PERM MMC component review of Cycle 1 States;
- obtained the MMC payments selected by CMS's statistical contractor for the PERM program's RY 2019 MMC review of Cycle 1 States;
- selected a random sample of MMC payments from CMS's statistical contractor's RY 2019 PERM program for the three States included in our audit;

- obtained and reviewed supporting file documentation maintained by CMS’s review contractor for each PERM MMC payment in our sample to determine whether the review contractor correctly identified payments as being made in accordance with Federal requirements;
- requested additional documentation from States (Illinois, Ohio, and Pennsylvania) for each PERM MMC payment;
- reviewed the documentation the States (Illinois, Ohio, and Pennsylvania) provided to assess whether CMS’s review contractor made the correct MMC payment review determination for each MMC payment included in our sample; and
- discussed the results of our review with CMS officials.

We provided CMS with a draft report on October 24, 2022, for review. CMS elected to not provide formal comments; however, it provided technical comments, which we addressed as appropriate.

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

## **APPENDIX B: STATISTICAL SAMPLING METHODOLOGY**

### **SAMPLING FRAME**

The sampling frame consisted of an Excel file containing 407 MMC payments totaling \$476,065 (\$291,356 Federal share) that were included in the MMC review component of the RY 2019 PERM program for 3 Cycle 1 States—Illinois, Ohio, and Pennsylvania.<sup>18, 19</sup>

### **SAMPLE UNIT**

The sample unit was a PERM MMC payment.

### **SAMPLE DESIGN AND SAMPLE SIZE**

We used a simple random sample of 100 PERM MMC payments.

### **SOURCE OF RANDOM NUMBERS**

We generated the random numbers using the Office of Inspector General, Office of Audit Services (OIG/OAS), statistical software.

### **METHOD OF SELECTING SAMPLE ITEMS**

We sorted the items in the sampling frame by PERM ID and then consecutively numbered the sample items. After generating the random numbers, we selected the corresponding frame items.

### **ESTIMATION METHODOLOGY**

We used the OIG/OAS statistical software to estimate the percentage and total dollar amount of PERM MMC payments in the sampling frame for which the review contractor made an incorrect MMC payment determination, including when the case file did not contain sufficient information and states were unable to provide relevant information to make a determination.

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<sup>18</sup> We judgmentally selected these States because they had the highest MMC Federal expenditures.

<sup>19</sup> Each sample unit represents a PERM MMC payment made between July 1, 2017, and June 30, 2018, for which CMS's review contractor determined whether the State paid in accordance with Federal requirements, the results of which were used to calculate the MMC Improper Payment Error Rate.

**APPENDIX C: SAMPLE RESULTS AND ESTIMATES**

**Table 1: Sample Details and Results**

	<b>Frame Size</b>	<b>Value of Frame</b>	<b>Sample Size</b>	<b>Value of Sample</b>	<b>Incorrect Payment Determinations in Sample</b>	<b>Value of Incorrect Payment Determinations In Sample</b>
<b>Total</b>	407	\$476,065	100	\$120,664	40	\$56,372

**Table 2: Sample Details and Results (Federal Share)**

	<b>Frame Size</b>	<b>Value of Frame</b>	<b>Sample Size</b>	<b>Value of Sample</b>	<b>Incorrect Payment Determinations in Sample</b>	<b>Value of Incorrect Payment Determinations In Sample</b>
<b>Total</b>	407	\$291,356	100	\$72,936	40	\$30,349

**Table 3: Estimated Value of Incorrect Payment Determinations in the Sampling Frame  
(Limits Calculated at the 90-Percent Confidence Level)**

	<b>Point Estimate</b>	<b>Lower Limit</b>	<b>Upper Limit</b>
Total Value	\$229,435	\$165,714	\$293,157
Federal Share	\$123,520	\$90,856	\$156,183

**Table 4: Estimated Percent of Incorrect Payment Determinations in the Sampling Frame  
(Limits Calculated at the 90-Percent Confidence Level)**

<b>Point Estimate</b>	<b>Lower Limit</b>	<b>Upper Limit</b>
40%	33%	47%