MEMORANDUM

Date: June 4, 2015

Subject: CMS Should Consider Whether Alternative Approaches Could Enhance Contractor Performance

OVERVIEW

In June 2015, the GAO released a report titled, “CMS Should Consider Whether Alternative Approaches Could Enhance Contractor Performance.” In this report, GAO found that the A/B and DME MACs are typically expected to carry out similar key responsibilities, a few of which accounted for most of their reported costs. Since the implementation of contracting reform, beginning in 2006, the key responsibilities included in MACs’ statements of work have generally remained consistent, with limited exceptions. Further, while similar key responsibilities accounted for the majority of A/B MACs’ and DME MACs’ costs, there were some differences between A/B MACs and DME MACs in the shares of total costs that were accounted for by certain responsibilities. Officials from the Centers for Medicare & Medicaid Services (CMS) and the MACs that GAO interviewed have identified lessons learned since the implementation of contracting reform, and they have made improvements to increase operational efficiency and effectiveness. However, both CMS and MAC officials identified challenges for continued improvements in MAC efficiency and effectiveness. CMS selected a cost-plus-award-fee contract structure for the MACs when it initially implemented contracting reform. While CMS has made modifications to its cost-plus-award-fee structure for MAC contracts, the agency has not formally revisited its MAC contracting approach since the implementation of contracting reform. Moreover, its assessment of alternative contracting approaches has been limited. The Federal Acquisition Regulation (FAR) states that changing circumstances may make different contracting approaches more appropriate later in the course of a series of contracts or a long-term contract than they were at the outset. Further, CMS indicated in its 2007 MAC acquisition strategy that once a baseline cost and level of effort had been established, the agency would reassess whether the cost-plus-award-fee contract structure was still appropriate for the MACs.

In this report, GAO states that there are a number of other contracting approaches that could be introduced within or in addition to the cost-reimbursement structure. Without formally assessing the potential benefits and risks of alternative contracting approaches, CMS may be missing opportunities to enhance MACs’ efficiency and effectiveness.

MACs’ Responsibilities Are Generally Similar and Have Remained Consistent Since Contracting Reform

According to CMS officials, with limited exceptions, MACs’ responsibilities are functionally similar across all of the MAC contracts. One exception is that there are slight differences between the responsibilities of the A/B MACs and those of the DME MACs. For example, DME MACs are not responsible for enrolling medical equipment suppliers in the Medicare program, whereas the A/B MACs have the responsibility of enrolling providers and suppliers. Other exceptions are: MACs can have different jurisdiction-specific responsibilities; MACs have had jurisdiction-specific responsibilities related to Medicare demonstration
projects regarding specific types of providers or for specific activities or services; and MACs often have different workloads for certain responsibilities, based on factors such as the provider mixes in their jurisdictions. CMS shared that MACs have generally remained the same since the implementation of contracting reform, although legislative changes have affected some of the MACs’ workloads for certain responsibilities.

Although there were some differences between A/B MACs’ and DME MACs’ reported costs, most of the reported costs for both the A/B MACs and the DME MACs were for a few key responsibilities. On average, both the A/B MACs and the DME MACs reported a large portion of their costs were incurred for similar activities, including claims processing and the Provider Customer Service Program. However, the A/B MACs reported a higher average percentage of their costs for financial management than did the DME MACs. Additionally, on average, the DME MACs reported a higher portion for appeals than did the A/B MACs. MACs’ reported total costs for their respective full contract years ranged from $41.4 million to $132.9 million, with an average of $81.3 million per MAC. Four responsibility areas—claims processing, financial management, Provider Customer Service Program, and provider enrollment—accounted for most of the nine A/B MACs’ reported costs during the most recent full contract year for which cost data were available. For the DME MACs the four DME MACs’ reported costs for their respective full contract years ranged from $20.3 million to $48.5 million, with an average of $31.8 million. For the DME MACs, most costs were incurred for only a few responsibility areas. Nearly three-quarters of DME MACs’ reported costs were for claims processing (about 28 percent), appeals (about 18 percent), the Provider Customer Service Program (about 17 percent), and Zone Program Integrity Contractor support services (about 11 percent).

CMS and MACs Have Identified Lessons Learned to Improve MAC Operations, but Also Challenges for Continued Improvements

Officials from CMS and the MACs agreed that they have learned many lessons since the initial implementation of the MAC contracts, and together, they have implemented improvements to increase the MACs’ operational efficiency and effectiveness.

CMS officials explained that they routinely encourage, solicit, and review ideas from MACs about how to improve their operational efficiency and effectiveness. These officials explained that they have gathered ideas about increasing efficiency and effectiveness from the MACs in the following ways:

- In contract solicitations, CMS instructs MAC offerors to propose programmatic or operational innovations they would implement if awarded a MAC contract and to describe the expected benefits of the proposed innovations.
- When MACs are transitioning into each new contract, CMS requires them to formally submit lessons learned documents, which detail challenges or other insights identified by MACs while transferring operations from previous contractors. These lessons learned may be beneficial to other MACs during future contract implementation periods.
• In the fall of 2013, CMS created an innovations submissions mailbox for the MACs to send in improvement or innovation requests. The MACs are to use this system when they want to implement a new process, service, technology, or other improvement, but there are funding needs or other contract requirements that CMS must approve in order for the MAC to implement the planned improvement.

• CMS convenes meetings annually with MAC executives, and they often discuss process improvement ideas at these meetings.

• CMS also acknowledges MACs’ ideas for significant process improvement through the Contractor Performance Assessment Reporting System, a web-based application it uses to record MAC performance evaluations.

• CMS and the MACs have convened workgroups related to various key responsibilities, in which the MACs collaborate and share ideas.

Officials from CMS and the four A/B MACs and one DME MAC listed the following examples of lessons learned and innovations that some of the MACs have implemented since the implementation of contracting reform.

1. **Provider self-service portals.** Three of the four A/B MACs and the one DME MAC stated that they had developed Internet-based provider self-service portals, which allow providers to validate their eligibility, submit claims electronically, request claim reconsiderations, and check the status of claims and reconsiderations, among other things. MAC officials said that this has reduced their expenditures on resources devoted to telephone-based provider customer service.

2. **Data analytics.** Officials from one A/B MAC described how they have begun using data analytics to more effectively identify provider-specific patterns of billing errors so that they can conduct targeted outreach and education to providers and try to prevent future billing errors.

3. **Clinical editing software.** CMS officials described the software that one MAC has deployed to improve the effectiveness of its prepayment edits. The software enables the MAC to electronically flag errors in Medicare claims that are not likely to meet the criteria for Medicare payment when the provider submits the claim for payment, rather than after the MAC begins processing the claim. The MAC explained that the provider is then offered an opportunity to correct errors before transmitting the claim to the MAC for payment. This reduces the resources this MAC must devote to the appeals process, the CMS officials said.

4. **Representation at administrative law judge hearings.** Another MAC described an innovation it had piloted in its DME MAC jurisdiction, which CMS has since required of all A/B and DME MACs. The innovation addresses the rate at which the MACs’ decisions to deny coverage for Medicare services or DME were being overturned at administrative law judge hearings, which are convened when the MAC and a Medicare qualified independent contractor have both determined that a claim should be denied and the beneficiary or provider disagrees with that determination. More of the MACs’ initial determinations are being upheld, which results in savings of Medicare dollars, the MAC said.
While they have made various changes since the implementation of contracting reform, CMS and the MACs described some challenges created by the structure of the MAC contracts that may constrain continued improvements in MAC efficiency and effectiveness. One challenge CMS officials identified was the 5-year limit on MAC contract terms, which they said constrained their ability to respond to issues with MACs’ performance. In addition, the CMS officials stated that a potential benefit of increasing the time between MAC contract competitions could be that CMS and the MACs would have more time to develop innovations and that the MACs would have more time to implement them to yield performance improvements. According to the MAC officials, the competitive nature of the MAC contracting environment has made MACs reluctant to share certain innovations or operational improvements with other MACs.

CMS Has Informally Considered Some Alternative Contracting Approaches but Could Do More to Assess Whether They Could Enhance MAC Performance

While CMS has made modifications to its cost-plus-award-fee structure for MAC contracts, the agency has not formally revisited its MAC contracting approach since the implementation of contracting reform. According to the FAR, changing circumstances may make certain contracting approaches more appropriate later in the course of a series of contracts or a long-term contract than they were at the outset. Moreover, CMS indicated in its 2007 acquisition strategy that once a baseline cost and level of effort had been established, the agency would reassess whether the cost-plus-award-fee contract structure was still appropriate for the MACs. However, CMS’s assessment of alternative contracting approaches since the implementation of contracting reform has been limited.

In recent contract justification documents, CMS has indicated why a firm fixed-price contract structure remains an unsuitable approach for MAC contracts and included a limited discussion of why the use of incentive fees—a type of fee available under the cost-reimbursement contract structure—would not be appropriate for MACs. While CMS’s decision to continue using the cost-reimbursement contract structure for the MAC contracts may be appropriate, there are a number of other contracting approaches that could be introduced within or in addition to the cost-reimbursement structure. CMS officials have discussed some of them internally but not documented any formal assessments of the alternatives by revising CMS’s 2007 MAC acquisition strategy. GAO states that without formally assessing the potential benefits and risks of alternative contracting approaches, CMS lacks assurance that the current contract structure is the optimal method for incentivizing MACs’ performance, and CMS may be missing opportunities to enhance MACs’ efficiency and effectiveness.

Following are four examples of potential alternative contracting approaches that may be permissible under the FAR along with some of the potential risks and benefits that CMS could consider. While some of these approaches are not explicitly mentioned in the FAR, they are also not prohibited.

1. **Using award terms.** One type of incentive available to CMS is the award term. Unlike the contract option years that exist under CMS’s current MAC contracting approach, which CMS can exercise at its discretion once it has complied with the FAR requirements for exercising an option, award terms...
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would incentivize MACs’ performance by automatically extending their contracts, as long as they met preestablished performance requirements.

CMS officials told GAO that, while they had not documented an assessment of this alternative, they had discussed it internally and concluded that the statutory 5-year limit on MAC contract terms limited the potential of the award-term approach to serve as a greater motivator to MACs’ performance than the option years that are available under the existing cost-plus-award-term contract structure. CMS had not formally analyzed the potential risks and benefits of the award-term approach in the context of the 5-year contract term or compared these to the current option year approach.

2. **Implementing negative performance incentives.** Under the FAR, agencies can also establish cost-reimbursement contracts with negative performance incentives. For example, under this type of contract, CMS theoretically could deduct from MACs’ base fees if they failed to meet certain performance thresholds. Alternatively, CMS could include nonmonetary negative incentives in MAC contracts, such as reducing the length of the contract if the MAC failed to meet established performance thresholds.

The CMS officials had not documented an assessment of whether monetary or nonmonetary negative incentives for poor performance would be appropriate for MAC contracts. However, they said that they had discussed it internally and concluded that the targets for existing MAC performance metrics are too high to accommodate negative performance incentives.

3. **Transitioning certain elements within the MAC contracts to a fixed-price structure.** In 2007, CMS documented its rationale for using a cost-reimbursement contract structure for the MAC contracts. However, while maintaining the overall cost-reimbursement contract structure, CMS could use a fixed-price contract structure for separate contract components; that is, CMS could set a firm price separately for certain contract responsibilities. In that case, the MACs would only be paid according to the fixed price for each contract component that was set at the beginning of the contract.

However, in previous documents, CMS stated that it would be too difficult to predict at the outset of each contract the workloads and specific costs that could be incurred for each of the MACs’ responsibilities. CMS officials GAO interviewed said they had engaged in some internal discussions about whether there were any elements within MACs’ contracts that could be transitioned from a cost-reimbursement to a fixed-price contract structure, but they had not formally analyzed the feasibility of doing so or which contract responsibilities have the potential to be appropriate for a fixed-price contract structure. Given that CMS has been collecting MAC cost reports for more than 8 years, the agency has the data it would need to analyze the potential benefits or risks of transitioning certain MAC responsibilities to a fixed-price structure.

4. **Transitioning certain elements of the MAC contracts to an incentive fee structure.** Another contracting approach available to CMS is the incentive fee. Under this arrangement, CMS would
establish target costs that it would expect each MAC to incur for each contract responsibility. Using an agreed-upon formula that CMS would negotiate with each MAC, if the total costs reported by the contractor were less than the target costs, the contractor would earn a total fee that is greater than the target fee. If the total costs were greater than the target costs, the MAC would earn a total fee that is less than the target fee.

CMS officials told GAO that they initially decided against using the cost-plus-incentive-fee contract structure for MACs because they believed that changing Medicare requirements precluded the establishment of specific cost, schedule, or performance targets from the outset of contracting reform, and CMS’s recent contract justification documents continue to reflect that belief. There is no indication, however, that CMS has engaged in an analysis that might help identify whether there are certain MAC responsibilities for which the cost-plus-incentive-fee approach might be feasible, without transitioning to this approach for all MAC contract responsibilities.

Conclusion
CMS has accumulated a considerable amount of data on MACs’ reported costs and performance under the cost-plus-award-fee contract structure the agency established when the first MACs became operational 8 years ago. The FAR states that certain contracting approaches may be more appropriate later in the course of a series of contracts or a long-term contract than they were at the outset, and CMS indicated in its 2007 acquisition strategy that it would revisit its contracting approach once it had collected baseline information. However, CMS has not engaged in a formal analysis of whether several other contracting approaches have the potential to increase MACs’ efficiency and effectiveness. Instead, recent contract justification documents have included a limited assessment of potential alternatives. Without using the wealth of data it has collected since the implementation of contracting reform to analyze other available contracting approaches, CMS may be missing opportunities to increase MACs’ efficiency and effectiveness.

Recommendation for Executive Action
GAO recommend that CMS conduct a formal analysis, using its experience and data it has collected since the implementation of the first MAC contracts, to determine whether alternative contracting approaches could be used—even if only for selected MAC contract responsibilities—to help promote improved contractor performance.

HHS Comment and GAO Evaluation
HHS concurred with this recommendation and said it plans to analyze alternative contracting approaches for MACs. Finally, HHS provided technical comments, which GAO addressed as appropriate.