Uncollected Revenues and Improper Payments Cost Kentucky Millions of Dollars a Year

Program Review and Investigations Committee

Greg Hager, Ph.D.
Committee Staff Administrator

Project Staff

Cindy Upton
Kara Daniel
Rick Graycarek
Margaret Hurst
Van Knowles
Erin McNees

Research Report No. 322

Legislative Research Commission
Frankfort, Kentucky
lrc.ky.gov

Adopted September 9, 2004

Paid for with state funds. Available in alternative form by request.

Foreword

Program Review staff would like to thank the many people who provided information for this report. Officials of many state agencies and organizations provided valuable assistance: Finance and Administration Cabinet (especially Ed Ross, Mack Gillim, Kim Moore, Bill Perry, Stuart Weatherford, Brett Antle, and Marie Bramblett); State Auditor of Public Accounts (Cindy James); State Treasurer (Eugene Harrell); State Budget Director (Beth Jurek, Bill Hintze, and Jim McWilliams); Attorney General (Ron Zellar, Ed Barnes, Todd Leatherman, and Marie Duvall); Cabinet for Health and Family Services (Mike Robinson, Robert Benvenuti, Steve Veno, Zach Ramsey, Miles Murphy, Kelli Hill, and Ron Kelien); Transportation Cabinet (Kenny Blackwell and Bob Scott); Administrative Office of the Courts (Donna Tucker, Neil Miller, Larry Bugg, and David Whittaker); Council on Postsecondary Education (Sandra Woodley); Department of Education (Kyna Koch and Susan Goins); Commerce Cabinet; Tourism Development Cabinet; and Environmental and Public Protection Cabinet.

Information was provided by other state and local entities: Webster County Attorney, Franklin County District Court, Franklin County Circuit Court Clerk; Christian County Circuit Court Clerk, Anderson County Office of Community Based Services, University of Kentucky, University of Louisville, and Murray State University. Information was provided by state associations: Kentucky Hospital Association and Kentucky Association of Homes and Services for the Aging. Information was obtained from national organizations: National Conference of State Legislatures; National Center for State Courts; and National Association of State Auditors, Comptrollers and Treasurers. Information was obtained from the federal government: Department for Health and Human Services Office of the Inspector General, Centers for Medicare and Medicaid Services, Federal Emergency Management Agency, Government Accountability Office, and Office of Management and Budget.

Finally, valuable information was provided by Legislative Research Commission staff: Barbara Baker, Sharon Cantrell, Karen Crabtree, John Cubine, Kim Eisner, Michael Meeks, Cindy Murray, Pam Thomas, Joyce Turley, and Frank Willey.

Robert Sherman
Director

Frankfort, Kentucky
September 9, 2004

Contents

Summary vii

Glossary xi

Chapter 1: Objectives and Conclusions 1

Major Conclusions 2
How This Study Was Conducted 4
Risk Assessment 4
Organization of the Report 5

Chapter 2: The Court of Justice: The Amount of Uncollected Debts Is Unknown; Collections Can Be Improved 7

Judicial Branch Accounts Receivable 7
Barriers to Improvement of Collections 8
Judicial Branch Information Systems 9
Case Management System 9
Bookkeeping System 10
Information Systems Do Not Track Accounts Receivable 10
Planned Improvements to Information Systems 11
Recommendation 2.1 12
Fines, Fees, and Court Costs 12
Categories of Assessments 12
Assessment and Collection Process 12
Circuit Clerk Bookkeeping Procedures 15
Distribution and Allotment of Money Collected 15
Fines 15
Fees 15
Court Costs 16
Clerks' Offices Are Not Audited Every Year 17
New Laws Affecting Collections 17
Recommendation 2.2 19
Write-off Criteria 19
Recommendation 2.3 19
Collection Methods 20
Bench Warrants' Effectiveness and Efficiency Questioned 20
Other Collection Methods Are Authorized but Are Not Used 20
Recommendation 2.4 21
Recommendation 2.5 21
Collection Practices in Other States 21
Tax Refund Intercepts 21
Centralized Statewide Collection Agencies 22

Strategies To Avoid Delay 22
Credit Card Payments 23
Recommendation 2.6 23
Collection Investigator Programs 23
Additional Methods 24
AOC Should Consider Implementing Additional Collection Techniques 24
Recommendation 2.7 25
Recommendation 2.8 26

Chapter 3: Medicaid: Procedures Can Be Improved for Preventing Improper Payments and Collecting Debts 27

Medicaid Spending Has Increased Significantly 28
Preventing and Collecting Improper Payments 29
Third-party Liability 29
Cost Avoidance 30
Recommendation 3.1 31
Collections 31
Detecting Errors and Fraud in the Medicaid Program 33
Edits and Audits 33
Ineligibile Recipients 34
An Investigative Program Was Discontinued 34
Recommendation 3.2 35
The Office of the Inspector General 35
Recommendation 3.3 37
Medicaid's Prescription Drug Costs 37
Medicaid's Drug Rebate Program 38
Recommendation 3.4 40
Recommendation 3.5 40
Recommendation 3.6 40
Reporting Drug Rebate Collections 40
Federal Audits of Drug Rebate Receivables 42
Medicaid Is Seeking a Pharmacy Benefits Manager 42
Supplemental Drug Rebates 43
Kentucky Attorney General's Investigations of Benefit Recipients and Caseworkers 43
Kentucky Attorney General's Investigations of Fraud by Medicaid Providers and Pharmaceutical Companies 45
Projected Collections Are Included in Agency Budget Requests 48

Chapter 4: Establishment and Enforcement of Child Support Orders Affect Eligibility and Participation in Public Assistance Programs 51

Administration of Child Support 52
Child Support Cases Are Increasing 53
Funding 53
Contracting Officials 53
Recommendation 4.1 55
Child Support and Food Stamps 55
Child Support and the Kentucky Transitional Assistance Program 56
Uncollected Child Support for Children Receiving Public Assistance Totals $159 Million 57
Retaining Child Support Payments 57
Financial Incentives for Cooperating With K-TAP Are Weak 58
Recommendation 4.2 59
Medical Support Orders and Medicaid 59
Most Medical Support Orders Are Not Fulfilled 60
Incentives for Avoiding Medical Support Orders 61
Unfulfilled Medical Support Orders Increase State Costs 62
Recommendation 4.3 63
Unfulfilled Child Support Payments Affect SEEK Funding 63

Chapter 5: The Finance and Administration Cabinet Can Lead the Efforts To Prevent Improper Payments and Collect Debts 67

Identifying and Preventing Improper Payments 68
Collecting Debts 69
The Federal Government's Approach 70
A Statewide Approach Is Recommended 71
Recommendation 5.1 72
Specific Actions Should Be Taken by State Entities 73
Recommendation 5.2 73
Recommendation 5.3 74
Specific Guidance Should Be Issued 74
Recommendation 5.4 75
Recommendation 5.5 76
Action Plans Must Be Implemented 76
Recommendation 5.6 76
All Available Collection Methods Should Be Considered 77
Recommendation 5.7 78
The Central Collection System Should Be Based on Best Practices From Other States 78
Recommendation 5.8 79
Develop a Statewide Policy for Deposits 79
Recommendation 5.9 79

Works Cited 81

Appendix A: The Risk-assessment Process for This Study 85
Appendix B: Strategies To Contain Medicaid Drug Costs 91
Appendix C: The Medicaid Drug Rebate Process 95
Appendix D: Ranking of County Child Support Offices for FY 2004 99
Appendix E: How Medicaid Savings From Noncustodial Parents Providing Medical Support Were Calculated 103
Appendix F: Time Value of Money 107
Appendix G: Response From the Administrative Office of the Courts 117
Appendix H: Response From the Cabinet for Health and Family Services 123
Appendix I: Response From the Finance and Administration Cabinet 137

List of Tables

3.1 State Share of Third-party Liability Collections and Cost Avoidance Savings ... 30
3.2 Components of the State Share of Third-party Liability Cost Avoidance 31
3.3 Components of State Share of Third-party Liability Collections 33
3.4 Attorney General's Special Investigations Division's Welfare Fraud Cases 44
3.5 State Share of Medicaid Fraud and Abuse Control Division's Recoveries 47
3.6 Medicaid Claims and Recovery Fund 49
4.1 Change in SEEK Expenditures by Various Hypothetical Changes in the Number of At-risk Students 65
E.1 Assumptions and Their Effects on the Estimate of Medicaid Cost Savings 105
F.1 Effect of Disbursements, Collections, Float, and Transaction Costs on Amounts Invested 107
F.2 Kentucky State Government Payments by Transaction Type, FY 2003 109
F.3 Payments to State Government by Transaction Type, FY 2003 110
F.4 Additional Annual Interest Income Generated From Investing Specified Funds One Day Sooner at a Given Annual Interest Rate 111
F.5 State Agencies Using ePay and Average Authorized Charges 114
F.6 Division of Occupations and Professions' Boards With Online License Renewal 115

List of Figures

2.A Assessment and Collection Process for Fines, Fees, and Court Costs 13
3.A Kentucky's Share of Medicaid Pharmacy Expenditures 37
3.B Medicaid's Drug Rebate Collection Process 39
3.C State Share of Medicaid Drug Rebate Collections 41
4.A Child Support Payments to K-TAP and Foster Care Families in Kentucky 58
4.B Health Insurance Orders in Kentucky and the U.S. 61
F.A ePay Process Flowchart for Credit and Debit Cards 113

Summary

On November 13, 2003, the Program Review and Investigations Committee authorized a study of the extent of improper payments and the effects of uncollected debts on the state's finances. The study did not include collection of unpaid taxes. The purpose of the study was to determine if more cash could be available to the Commonwealth if policies and procedures were improved. The terms below are explained to facilitate common understanding in this report.

- "Improper payments" are overpayments and include amounts that should not have been paid or were paid for the wrong amount.
- "Nontax revenue" means state income that is not classified as a tax. Common sources are hunting and fishing licenses, car and truck licenses, business permits, lodging charges at state parks, federal funds, and investment income.
- "Debts" are nontax revenue that has not been collected.
- "Accounts receivable" are debts recorded in an agency's accounting records.

The terms "debt" and "account receivable" are used interchangeably in this report to indicate money owed to the state that has not been collected.

Major Conclusions

Debts owed to the courts for unpaid court costs, fines, and fees cannot be determined. The courts have neither a bookkeeping system capable of tracking total unpaid debts nor an effective way to pursue debtors who do not pay. The funds in question are significant. For example, a 10 percent increase in court collections would provide more than $3 million to the general fund and increase restricted funds as well.

Public benefit programs such as Medicaid make improper payments because of errors and fraud by providers, recipients, and state agency personnel. Medicaid may be making improper payments because information is not always available on other insurance that should be billed prior to Medicaid. Medicaid and other public benefit programs also make improper payments because of a lack of procedures to prevent the payments. Finally, as described in the 2004 Program Review report on the Kentucky Transitional Assistance Program, that program may be spending $4.5 million dollars more than required by the federal government.

Medicaid does not collect all drug rebates owed because of fraudulent pricing information provided by pharmaceutical companies. A drug rebate is an amount that, by federal law, must be returned to the state by a pharmaceutical company for the privilege of making its drugs available to Medicaid recipients. The state recovers amounts owed when fraud by the company is discovered. More than $7 million in state funds has been recovered in the past five years.

Medicaid has an incentive to collect overpayments to providers. Medicaid's recoveries of overpayments to providers due to third-party liability totaled more than $3 million in fiscal year 2002. Medicaid also has an incentive to prevent overpayments. In 2002, the state avoided making improper payments of $190 million. This "cost avoidance" is a Medicaid success story that can be made even more successful.

Unenforced child support orders place an extra financial burden on public assistance programs. Child support is collected at the local level, usually by a county attorney whom the state pays by the hour. In Kentucky, a medical support order usually is an "all-or-nothing" proposition, meaning that the noncustodial parent either provides health insurance for the children or provides nothing toward the children's medical support. Orders for medical support are not emphasized in child support orders, thus increasing the cost to the state of providing health care coverage to the children through the Medicaid program or the Kentucky Children's Health Insurance Program. The county attorneys do not receive additional payments from the state for ensuring that medical support orders are enforced. If noncustodial parents provided health insurance as ordered by a court, an estimated $2.4 to $11.0 million in state Medicaid costs could be saved.

Unenforced child support orders also place an extra financial burden on the public school system. School districts receive additional state funding for children who qualify for free lunch. If child support collections were increased to make 5 percent fewer students eligible for free lunch, the Commonwealth would save more than $6 million a year.

The cost-effectiveness of collecting debt depends on how much is owed, how much is reasonably collectible, and how much the state will spend to collect it. The federal government often pays part of the cost. For example, for every dollar spent on child support enforcement, the federal government pays 66 cents and the state pays 34 cents. Federal funding must be considered in any cost-benefit analysis of collections.

New legislation provides ways the state can prevent improper payments and collect debts. However, specific policies and procedures are still being developed. Best practices of other states and the federal government should be considered in developing efficient and effective policies and procedures for the Commonwealth.

Recommendations

The full text of each recommendation can be found in the report. The following is a summary by chapter.

Chapter 2 describes the inability to track and collect debts for the court system.

2.1 The Administrative Office of the Courts (AOC) should consult with the Finance and Administration Cabinet (Finance) in designing and implementing a new computerized bookkeeping system.

2.2 AOC should consult with Finance to consider the feasibility of implementing interim policies until the new bookkeeping system is in place.

2.3 AOC should work with Finance to develop guidelines to assess the collectibility of outstanding debts.

2.4 AOC should review the feasibility of using criminal garnishments to collect unpaid debts. Garnishments include collecting amounts owed the state from debtors' bank accounts and wages.

2.5 AOC should consult with Finance and the State Treasurer to determine the feasibility of withholding debts from state payments such as salaries and retirement benefits.

2.6 AOC should consult with Finance to implement the acceptance of credit card payments by the courts.

2.7 AOC should study other states' collection systems for best practices that could be used in Kentucky.

2.8 AOC should consult with Finance to develop a strategic plan to collect debts.

Chapter 3 describes how Medicaid and related public assistance programs make improper payments and fail to collect debts.

3.1 The General Assembly may wish to consider amending current law to enable Medicaid to better avoid paying claims that are the responsibility of a liable third party.

3.2 The Cabinet for Health and Family Services (CHFS) should review the feasibility of establishing a field-based investigation unit to identify recipients or applicants for public benefits who fraudulently try to obtain benefits.

3.3 The CHFS Inspector General should implement the planned expansion of audit and investigation functions and develop a method to report the results.

3.4 Medicaid should actively try to collect all drug rebates and interest owed by all pharmaceutical companies.

3.5 Medicaid should monitor interest charges on all invoices to drug manufacturers.

3.6 Medicaid should resolve disputed amounts in the backlog of drug rebate receivables.

Chapter 4 describes how unenforced child support orders affect public assistance programs and state funding of the public school system.

4.1 CHFS should re-examine the costs and benefits of providing financial incentives to county offices for improving enforcement of child support orders.

4.2 CHFS should examine the consequences of allowing custodial parents who receive K-TAP to keep some or all of their child support payments.

4.3 Noncustodial parents who cannot provide health insurance should be required to provide some financial assistance for medical bills.

Chapter 5 provides an overview of the requirements of new state laws for payment and collection procedures of state agencies and the courts. It also reviews best practices being used by other states and the federal government.

5.1 Finance should establish a formal risk assessment work group to address improper payments and debt collection.

5.2 State agencies identified as being most at risk of making improper payments or not collecting debts should take specific actions to correct problems and report the results. Specific targets for preventing or detecting improper payments and collecting debts should be established.

5.3 The court system should take specific actions to correct debt-collection problems and report the results. Specific targets for collecting debts should be established.

5.4 Finance and the State Budget Director should issue specific guidance to agencies and the court system to help them satisfy targets for preventing improper payments and collecting debts.

5.5 The General Assembly should consider requiring Finance to report annually on state agencies' improper payments.

5.6 Finance and the State Budget Director should help state agencies implement action plans, internal controls, and preaudit procedures.

5.7 All state entities should explore the use of all available collection methods and implement those that are cost-effective.

5.8 Finance should include best practices from other states in the debt-collection system.

5.9 Finance and the State Treasurer should develop a statewide policy to ensure that collections are deposited on the day they are received.

Glossary

ACH: automatic clearinghouse
AMP: average manufacturer's price (used in calculating drug rebates receivable)
AOC: Kentucky Administrative Office of the Courts
BP: best price (used in calculating drug rebates receivable)
CAFR: Comprehensive Annual Financial Report
CFOC: Chief Financial Officers Council
CHFS: Kentucky Cabinet for Health and Family Services
CMIA: federal Cash Management Improvement Act
CMS: federal Centers for Medicare and Medicaid Services, located in the U.S. Department of Health and Human Services
CORE: Cooperative Review of Eligibility program
DCBS: Kentucky Department for Community Based Services
FDA: U.S. Food and Drug Administration
FEMA: Federal Emergency Management Agency
GAO: U.S. Government Accountability Office (formerly the U.S. General Accounting Office)
HHS: U.S. Department of Health and Human Services
K-TAP: Kentucky Transitional Assistance Program
KASPER: Kentucky All-Schedule Prescription Electronic Reporting
KCHIP: Kentucky Children's Health Insurance Program
KRS: Kentucky Revised Statutes
KYVU: Kentucky Virtual University
MARS: Management Administrative and Reporting System (the electronic statewide accounting and management system)
MFCU: Kentucky Medicaid Fraud Control Unit, located in the Attorney General's Office
MMIS: Medicaid Management Information System
NCSC: National Center for State Courts
OIG: Office of Inspector General
OMB: U.S. Office of Management and Budget
PCG: Public Consulting Group (a Medicaid contractor)
PCIE: President's Council on Integrity and Efficiency
SEEK: Support Educational Excellence in Kentucky (the funding formula for public school districts)
TANF: federal Temporary Assistance to Needy Families program
TPL: third-party liability

Chapter 1

Objectives and Conclusions

The purpose of this study is to determine if more cash could be available to the Commonwealth if policies and procedures were improved.

The purpose of this study is to determine if more cash could be available to the Commonwealth if policies and procedures were improved for preventing improper payments and collecting nontax debts. The terms below are explained to facilitate common understanding in this report.

- "Improper payments" are overpayments and include amounts that should not have been paid or were paid for the wrong amount.
- "Nontax revenue" means state income that is not classified as a tax. Common sources are hunting and fishing licenses, car and truck licenses, business permits, lodging charges at state parks, federal funds, and investment income.
- "Debts" are nontax revenue that has not been collected.
- "Accounts receivable" are debts recorded in an agency's accounting records.

The terms "debt" and "account receivable" are used interchangeably in this report to indicate money owed to the state that has not been collected.

Some improper payments are made in error. Other improper payments are due to fraud, which is intentional.

Some improper payments are caused by errors such as paying the same invoice twice or paying the wrong amount. Other improper payments are caused by fraud. Fraud is intentional. A person or a company commits fraud by obtaining something of value, often money or services, by deliberately misrepresenting important facts. An example of fraud is a person using someone else's Medicaid card for a visit to the dentist.

Errors and fraud cause the state to make improper payments. When the improper payments are discovered, they become debts owed to the state. Debts that are not caused by improper payments include unpaid court costs, fines, and fees.

The study focused on policies and procedures for preventing and identifying improper payments and collecting debts.

The objectives of this study were to determine how state entities prevent improper payments and identify them when they occur, how state entities identify and collect debts, and how policies and procedures could be improved.

Major Conclusions

Staff reached seven major conclusions:
1. The total debt owed to the courts cannot be determined.

In addressing the objectives, staff reached seven major conclusions.

1. Debts owed to the courts for unpaid court costs, fines, and fees cannot be determined. The courts do not have a system to track total unpaid debts or an effective way to pursue debtors who do not pay. A 10 percent increase in collecting court costs and fines would provide more than $3 million to the general fund and also would increase restricted funds.

2. Public benefit programs are victimized by errors and fraud.

2. Public benefit programs make improper payments because of errors and fraud by providers, recipients, and state agency personnel. Programs also make improper payments because of a lack of procedures to prevent these payments. For example, in 2002, the Cabinet for Health and Family Services discontinued a program that investigated the eligibility of recipients or applicants who were suspected of fraudulently obtaining benefits. Cabinet officials say a new investigative program will be put in place. The Cabinet did not have sufficient controls in place to prevent caseworkers from fraudulently obtaining benefits for themselves and others. Cabinet officials say they are taking steps to prevent similar problems. Finally, as noted in the June 2004 Program Review report on the Kentucky Transitional Assistance Program, the state may be spending $4.5 million more than the federal government requires.

3. Medicaid does not collect all drug rebates owed by pharmaceutical companies.

3. Medicaid does not collect all drug rebates owed because of fraudulent pricing information provided by pharmaceutical companies. These fraudulent practices are beyond Medicaid's control. More than $7 million has been recovered for the Commonwealth in the last five years from the companies. Additional recoveries are expected, but Program Review staff cannot predict the amount.

4. Medicaid has an incentive to prevent overpayments to providers and to recover overpayments when they are discovered.

4. Medicaid has an incentive to prevent overpayments to providers and payments that should be made by third parties, such as Medicare and private insurance. Medicaid would also benefit from recovering improper payments when they are discovered. Avoiding the cost up front means state money can be invested to earn interest. Medicaid avoided improper payments of $190 million in FY 2002 by ensuring that Medicare and private insurance paid claims first. In addition, the state collected more than $3 million in FY 2002 from liable

third parties. Trying to collect an overpayment after the fact increases administrative costs and the chance that the state will lose money. The state pays 30 percent of the cost of a Medicaid service, and the federal government pays 70 percent. When Medicaid reports to the federal government that an overpayment has been made, the federal government withholds its 70 percent share of the amount from future payments to the state. As a result, the state ultimately pays 100 percent of the cost of an overpayment but gets to keep 100 percent of a recovery.

5. Unenforced child support orders place an extra financial burden on state government.

5. Unenforced child support orders place an extra financial burden on the state's public assistance programs and the public school system. When child support orders are not enforced, a family's income is negatively impacted, thus qualifying additional families for programs such as Food Stamps, K-TAP, and Medicaid. If child support collections were increased to make 5 percent fewer students eligible for free lunch, the Commonwealth would save more than $6 million a year in public school funding. Program Review staff estimate that $2.4 to $11.0 million in state Medicaid costs could be saved if noncustodial parents provided health insurance as ordered by a court.

6. Whether it is cost-effective to collect debts depends on how much is owed and collectible and how much the state must spend to collect it.

6. The cost-effectiveness of collecting debt depends on how much is owed, how much is reasonably collectible, and how much the state must spend to collect it. In programs with a federal component, the federal government generally pays a portion of the collection cost. For example, for every dollar spent on child support enforcement, the federal government pays 66 cents and the state pays 34 cents. Federal participation in the cost of program administration must be considered in any cost-benefit analysis.

7. Laws enacted in 2004 provide new ways the state can prevent improper payments and collect debts.

7. House Bill 162 and Senate Bill 228, enacted by the 2004 regular session of the General Assembly, amend existing statutes to provide new ways the state can prevent improper payments and collect debts. The Finance and Administration Cabinet has already started collecting certain debts under the new laws. Specific policies and procedures are being developed. Best practices of other states and the federal government should be considered in developing efficient and effective policies and procedures for the Commonwealth.

How This Study Was Conducted

The nature of this study necessitates more of a focus on research methods and details than in a typical report. Given that the subject of this study is relevant to most state agencies, it is critical that readers have an explanation of why this report emphasizes the themes and programs that it does.

Each program and activity discussed in this report is sufficiently complex to justify its own Program Review evaluation. Ideally, all improper payments should be prevented and all debts collected. However, in an effort to prioritize, Program Review staff focused primarily on programs and activities that could potentially produce millions of dollars in collections or savings for the Commonwealth.

In addressing the study objectives, staff were guided by several considerations:

- Priority should be given to collecting *state* funds;
- The focus should be on areas that would potentially result in significant amounts of money for the Commonwealth;
- Some collections and savings should result in potential new money, meaning that the money was not included in the budget;
- The cost of preventing improper payments and collecting debts should be taken into account;
- Many entities receiving state funds are regularly audited; and
- Staff working on this report should not duplicate work being done through investigations by others.

Risk Assessment

The risk of improper payments and the risk of failure to collect debts were considered throughout this study.

Throughout this study, staff assessed the risk that state entities make improper payments and/or fail to collect debts. To focus on areas most likely to result in significant collections or savings (millions of dollars rather than thousands), staff performed several steps:

- Reviewed audit and evaluation reports from states and the federal government to identify programs and activities that others had found to be at risk of making improper payments or not collecting debts;
- Reviewed state and federal laws, regulations, and policies for preventing improper payments and collecting debts;
- Interviewed officials of and obtained information from state, federal, and local agencies and other entities;

- Reviewed potential improper payments and whether recovering the money would result in increased cash to the state;
- Reviewed state entities' policies and procedures for preventing improper payments and collecting debts;
- Focused on noncurrent accounts receivable, which are debts that are not expected to be collected for an extended period after the end of the fiscal year;
- Considered whether money owed for goods and services is likely to be collected in the ordinary course of business;
- Considered state procedures for accessing allocated federal funds;
- Considered how and when state and local government entities are audited, including ongoing audits and investigations; and
- Pursued evidence that unenforced child support orders cause unnecessary costs for other state programs.

A detailed description of the risk-assessment process is described in Appendix A.

Organization of the Report

Chapter 2 describes the court system's inability to track and collect debts. Recommendations are made to (a) implement a computerized bookkeeping system for collections and outstanding debts, (b) consider interim policies until the bookkeeping system can be implemented, (c) assess the collectibility of outstanding debts, (d) consider the use of criminal garnishments, (e) consider the withholding of debts from state disbursements, (f) consider the acceptance of credit card payments, (g) study other states' collection systems, and (h) develop a strategic plan for collecting debts.

Chapter 3 describes how Medicaid and related public assistance programs make improper payments and fail to collect debts. Recommendations are made to (a) consider strengthening the state's ability to identify other parties that are liable for health care costs paid by Medicaid, (b) implement a stronger internal control system to prevent ineligible persons from obtaining benefits, (c) strengthen the role of the inspector general, (d) actively pursue drug rebate collections, (e) monitor interest charges on all drug rebate invoices, and (f) resolve disputed drug rebate invoices.

Chapter 4 describes how unenforced child support orders affect public assistance programs and state funding of the public school system. Recommendations are made to improve collections by (a) re-examining the costs and benefits of providing financial incentives to county child support offices for improving enforcement of child support orders, (b) examining the consequences of allowing custodial parents who receive K-TAP to keep some or all of their child support payments, and (c) determining whether noncustodial parents who cannot provide dependent health insurance should be required to provide some financial assistance for dependent medical care. Estimates are provided for a range of possible savings to Medicaid if child support orders were better enforced.

Chapter 5 provides an overview of the requirements of new laws for payment and collection procedures of state agencies and the court system, as well as actions being taken to implement them. This chapter also provides a review of best practices by other states and the federal government. Recommendations are made to (a) establish a statewide work group on risk assessment to consider the risks of making improper payments and not collecting debt, (b) specify actions that should be taken by state agencies, (c) specify actions that should be taken by the Court of Justice, (d) specify guidance that should be issued to agencies, (e) establish reporting requirements for improper payments, (f) provide assistance in implementing plans for reducing improper payments and collecting debts, (g) explore the use of all available collection methods, (h) include best practices of other states and the federal government in designing the central collection system, and (i) develop a statewide policy for deposits.

The written response to this report from the Administrative Office of the Courts is included as Appendix G. The written response from the Cabinet for Health and Family Services is Appendix H. The written response from the Finance and Administration Cabinet is Appendix I.

Chapter 2

The Court of Justice: The Amount of Uncollected Debt Is Unknown; Collections Can Be Improved

This chapter describes how courts assess and collect fines, fees, and costs; relevant new laws and their effects; planned changes to the courts' information system; and other states' collection methods.

The judicial branch assesses and collects millions of dollars each year in fines, fees, and court costs, yet little is known about the amount that goes uncollected and the effectiveness of the judiciary's collection techniques. Uncollected debt raises not only the issue of lost revenue for the Commonwealth but also the loss of integrity of the courts when court orders remain unenforced. This chapter reviews the courts' information systems; the current process of assessing and collecting fines, fees, and costs; and newly enacted laws that will affect that process. This chapter also describes what other states are doing to improve court collections.

Recommendations are made for the court system, usually in collaboration with the Finance and Administration Cabinet, to (a) implement a computerized bookkeeping system to record and report amounts owed and collected, (b) consider interim policies until the bookkeeping system can be implemented, (c) assess the collectibility of outstanding debts, (d) consider the use of criminal garnishments to collect debts, (e) consider the withholding of debts from state disbursements, (f) consider the acceptance of credit card payments, (g) study other states' collection systems, and (h) develop a strategic plan for collecting debts.

Judicial Branch Accounts Receivable

For the judicial branch and its administrative agency—the Administrative Office of the Courts (AOC)—the concern is collecting money owed, not avoiding and collecting improper payments. AOC does not administer benefits programs that require outlays of money that may be spent erroneously. According to an AOC official, the largest expenditure for AOC is the payroll of judicial branch employees. Other expenses include the purchase of supplies and payment of utility bills. These expenses are subject to random checks and audits.

Money owed to the judicial branch comes primarily from the assessment of fines, fees, and court costs.

The money owed to and collected by the judicial branch comes primarily from the assessment and collection of fines, fees, and court costs. AOC reports that the state's circuit clerks collected approximately $37.4 million in fines and costs in FY 2002 and approximately $65.2 million in fines and costs in FY 2003. There

is no evidence that this increase in the amount collected was due to improved collection procedures. Court costs were statutorily increased effective August 1, 2002, from between $49 and $82 to $100 (Ky. Acts ch. 183 §4). As a result of the increase, more court costs were collected, but the number of fines collected was stable.

The circuit court clerks' offices collect myriad other fees and costs such as civil filing fees, driver's license fees, and bail costs; however, collection of those amounts is not addressed in this report. Those fees and costs are generally paid at the time of service and no debt is created.

Little is known about court debts that are not collected.

New state laws require the judicial branch to track and collect debts; however, due to bookkeeping and case management practices, little is known about the amounts of fines, fees, and costs that are assessed by the courts but not collected. Courts track the amounts assessed and the status of collection in individual cases, but amounts owed the courts are not tracked and reported in the aggregate as accounts receivable. Accordingly, AOC could not provide information about the total amount outstanding or the percentage of total assessments that remains uncollected.

Collection efforts are left up to the individual judges on a case-by-case basis.

Officials with AOC acknowledged that neither they nor the circuit clerks have employees whose duties include attempting to collect unpaid amounts. Collection efforts are left up to the individual judges on a case-by-case basis. AOC officials stated that the threat of going to jail often motivates people to pay the assessed costs, fines, and fees. If a defendant fails to pay, a judge can issue a bench warrant or criminal summons. After that, the court's monitoring of the matter typically ends unless the warrant or summons is served by law enforcement and the defendant is brought back before the court. If the defendant is never arrested or served, the fines, fees, and costs may remain unpaid indefinitely.

Barriers to Improvement of Collections

The judicial branch has little financial incentive to invest resources to improve collections.

One significant barrier to improving collections by the judicial branch is the lack of incentive for it to do so. The distribution of court costs allocates only 5 percent for use by the judicial branch to hire additional clerks and supplement salaries. No portion of the fees and fines collected is set aside for the courts. Accordingly, there is little financial incentive for the judicial branch to invest the time and money necessary to assess its collection performance, investigate additional collection policies, and implement those that would be most effective.

The somewhat decentralized structure of the judicial branch makes it difficult and time-consuming to implement changes.

The somewhat decentralized structure of the judicial branch makes it difficult and time-consuming to implement changes. Although Kentucky's constitution creates a single, unified court system with the Chief Justice of the Kentucky Supreme Court as the executive head of the judicial branch, all of the judges and circuit clerks within that branch are elected state officers who are accountable primarily to the electorate (Ky. Const. § 109).

The Chief Justice and AOC exercise considerable control over judicial branch administration.

Despite that, the Chief Justice and the staff of AOC exercise considerable control over the judicial branch in administrative matters. Past experience with numerous provisions make it clear that the courts and clerks across the state would implement new accounts receivable and collections policies required by AOC if AOC should choose to impose them (see Ky. Const. §116; KRS 30A.010). However, the existence of multiple, separate jurisdictions across the state presents significant challenges to fully implementing any new policies.

Judicial Branch Information Systems

The amount of money collected is known; however, information systems do not track the total amount uncollected.

The circuit clerks and AOC know how much money is collected each month, and the circuit clerks track how much is assessed and collected in individual cases. However, the tracking systems in place do not provide any manageable means of learning how much money is owed but not collected. Each circuit clerk uses separate case management and bookkeeping systems that do not communicate with each other, and not all clerks are using the same systems.

Case Management System

Three versions of the case management system are in use across the state.

For management of individual cases, clerks' offices in more than 80 counties are using a Windows-based computer system called Kentucky Courts II. AOC released that program in October 2002 and expects it to be installed and operational in all Kentucky counties by March 2005. The remaining counties are using that system's predecessors—Kentucky Courts I or Sustain—to manage cases. When costs, fines, or fees are assessed and payments are received, personnel in the clerk's office update the information in the case management system to reflect those assessments and receipts. A deputy clerk can access the case management system at any time to learn the status of a particular case and how much money, if any, is owed.

Bookkeeping System

Two bookkeeping systems are in use across the state, one of which is a manual system.

Just as there are different case management systems in use, not all clerks are using the same bookkeeping system. AOC reports that approximately 78 counties are using a DOS-based automated receipts and bookkeeping system first introduced in the late 1980s. That system tracks cash drawer transactions; issues receipts for payments received; summarizes receipts, bank deposits, and disbursements; and allocates the receipts to the appropriate categories. The remaining counties, with the exception of one pilot program, are using a manual system for the same purposes.

Information Systems Do Not Track Accounts Receivable

The information systems in use do not track accounts receivable or allow accounts receivable information to be added to learn the total amount outstanding.

The amount owed in each individual case is entered into the case management system. Unfortunately, that financial information is contained within a text or memo field in the case management system, which does not provide a way to reduce the amounts assessed to reflect reductions for time served or community service. AOC officials state that although accounts receivable information is in the system and allows individual case tracking, it cannot be extracted electronically and added to learn the total amount outstanding. Officials state that in order to learn the total amount outstanding for the state, personnel in each clerk's office would have to look at every open case in which fines, fees, and costs were imposed to determine the amount outstanding and add those figures together.

An AOC official stated that it has been difficult to address uncollected debts because of the status of the information systems and the difficulty of developing and installing new systems and training personnel in each county.

AOC officials also state that the bookkeeping system does not track receipts by individual case and does not include information about the amount owed. It also cannot communicate with the Windows-based case management system, which limits its usefulness in tracking accounts receivable.

When asked about uncollected costs, fees, and fines, an AOC official stated that the issue has been difficult to address for several reasons. One reason is the status of the case management and bookkeeping systems. Because three different case management systems are in use across the Commonwealth, an AOC official stated that the implementation of Kentucky Courts II in all 120 counties has been a priority. Statewide implementation is expected to be completed in March 2005 and will have taken 42 months from start to finish. At the same time, AOC has been working to install the DOS-based automated bookkeeping system. An AOC official stated that the bookkeeping system is being addressed and

will be given priority after the installation of Kentucky Courts II is complete.

AOC has not made collecting and tracking accounts receivable a priority.

AOC officials explained that the implementation has taken so long, in part, due to a lack of personnel available to conduct the necessary on-site training. The personnel involved must travel to the clerks' home counties to provide training and support as the new program is installed and used for the first time. These personnel are not hired solely to provide training and have other regular duties in the day-to-day operations at AOC. Additionally, some positions have been vacant due to a hiring freeze. Despite these obstacles, it seems clear that AOC has not made collecting and tracking accounts receivable a priority.

Planned Improvements to Information Systems

A new receipts system is being tested in one county and a new bookkeeping system is being developed. The new systems should enable AOC to determine the amount of outstanding accounts receivable but only from the date of implementation forward.

New systems are being developed that will track accounts receivable. AOC has developed a new automated system to track receipts, which is being piloted in Owen County. Officials stated that it has been well received and is performing well. AOC is also developing a bookkeeping component that will work with the new receipts system. Both the new receipts and new bookkeeping systems will be compatible with Kentucky Courts II and, although some additional programming will be required, the new programs should enable AOC to determine the amount of outstanding accounts receivable from the date of implementation forward. The systems will not capture any accounts receivable that pre-date the implementation of the programs.

AOC is unable to determine when the new systems will be implemented statewide.

AOC officials state that they do not yet know how long it will take to develop and implement the new receipts and bookkeeping systems. They note that even after the bookkeeping portion of the program is developed, it will take some time to implement the program statewide. Because only their internal auditors train the circuit clerk bookkeepers, AOC will have even fewer employees available to provide that training than those who have been used to provide training on Kentucky Courts II. Additionally, bookkeeping training is generally conducted one-on-one in each county, whereas a portion of the Kentucky Courts II training was provided to small groups of employees from four or five counties at a time.

Recommendation 2.1

AOC should consult with the Finance and Administration Cabinet in designing and implementing its new computerized bookkeeping system to enable the courts to record and report amounts assessed, payments received, reductions in sentences, remaining unpaid balances, the age of any unpaid balances, and balances that should be pursued for collection.

Fines, Fees, and Court Costs

Categories of Assessments

A person convicted of a felony, misdemeanor, or traffic violation may be ordered to pay fines, fees, and court costs.

In Kentucky's judicial system, a person convicted of a felony, misdemeanor, or traffic violation may be ordered to pay various fines, fees, and court costs. A fine is a financial penalty assessed by the court against an individual for violating the law. Fines are assessed for traffic infractions, littering, and various misdemeanors such as public intoxication. A fee is an additional amount set by statute and assessed by the courts. A fee is generally charged in connection with a particular crime and is used to fund a particular program. Examples include fees for alcohol intoxication and driving under the influence.

A judge may waive fines or fees but cannot waive court costs unless the person is indigent.

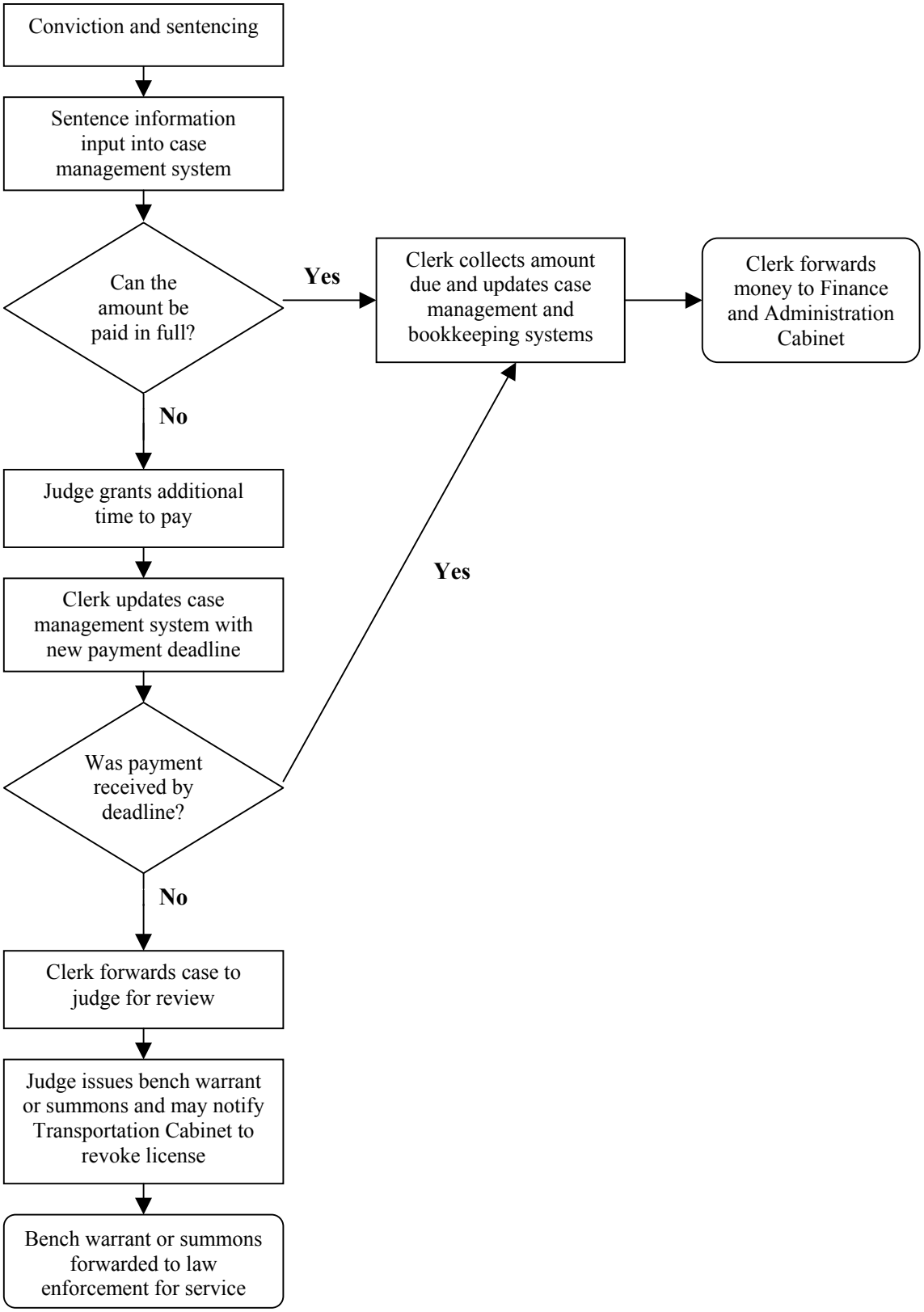
Court costs for criminal cases are a statutorily set amount: $125 per criminal case and assessed against a convicted defendant in addition to any applicable fine or fee. A judge may waive fines or fees in a given case but is prohibited by statute from waiving court costs unless the court finds the defendant is a "poor person" within the meaning of the statute (KRS 23A.205; KRS 453.190). If the defendant is unable to pay but does not qualify as a poor person, the court may establish an installment payment plan not to exceed one year. KRS 23A.205 requires that installment payments be applied first to court costs, then to restitution, fees, and fines, respectively.

Assessment and Collection Process

Upon conviction, the judge sentences the defendant and assesses costs, fines, and fees.

When a defendant is found guilty of a crime or violation, the judge sentences the defendant and assesses costs, fines, and fees as appropriate. Typically, an employee of the circuit clerk's office is working in the courtroom and records the judgment and the amounts due in each category. Deputy clerks then enter that information into a computerized case management system used to track each case. Figure 2.A provides an overview of the courts' assessment and collection process.

Figure 2.A
Assessment and Collection Process for Fines, Fees, and Court Costs



If a defendant is unable to pay, the court may allow additional time.

If the defendant claims to be unable to pay the amount due at his or her court appearance, the judge may grant additional time to pay the entire amount due or establish a payment plan. This deferral of payment is within the judge's discretion, so the practice varies somewhat among jurisdictions. The clerk enters the information in the case management system to establish the next payment deadline for that case in accordance with the judge's instructions.

If a defendant fails to pay, the court may issue a bench warrant or criminal summons.

If the defendant makes a payment to the clerk's office, the clerk updates the case management system to show the date and amount received. If the amount due is paid in full, the clerk deletes the upcoming review date. If payment in full is not received, the case will come up for review on the scheduled payment deadline. The clerk gives the case to the judge who reviews the case and decides how to proceed. Although procedures vary among jurisdictions, the reviewing judge typically issues a bench warrant for the defendant's arrest or sets a court appearance and issues a criminal summons requiring the defendant to appear in court. The court forwards the warrant or summons to law enforcement officials for service.

If the defendant does not pay and is never arrested, monitoring of that case by the judge or clerk's office typically ends. The debt may never be collected.

No new review date is entered into the case management system; although, if the case is reviewed, the case management system will continue to reflect the unpaid debt. If the defendant is never arrested and never voluntarily pays, the warrant may remain outstanding and the fines, fees, and costs unpaid indefinitely. If arrested on a bench warrant, the defendant will not be released from jail until the outstanding amount is paid or the defendant may be ordered to serve time in jail in lieu of making payment.

In some traffic cases, the Transportation Cabinet can suspend a person's driver's license.

In some traffic cases, judges may use an alternative to encourage defendants to pay. If a defendant fails to appear in court after receiving a citation or summons or fails to appear after a court has ordered him or her to provide proof of insurance, the judge can notify the Transportation Cabinet, which can suspend the defendant's driver's license (KRS 186.570). The license will not be reinstated until the defendant has paid the outstanding fines and costs.

Circuit Clerk Bookkeeping Procedures

Clerks accept payment, update the bookkeeping and case management systems, and forward the money to the Finance and Administration Cabinet for distribution.

A convicted defendant pays the assessed court costs, fees, and fines to the circuit clerk's office. Office personnel accept the payment. Relevant information such as the case number and amount collected in each category (cost, fee, or fine) then is entered into the bookkeeping system. A receipt is provided to the defendant. The payment information is also recorded in the case file for entry into the case management system. Cash drawers are balanced daily and receipts, deposits, and disbursements are summarized. Money collected is deposited daily in an interest-bearing account. AOC auditors routinely work with the circuit clerks to identify any money that can be invested in higher-yield accounts. All interest earned goes to the general fund. Once a month, the circuit clerks transfer the money collected through this process to the Finance and Administration Cabinet.

Distribution and Allotment of Money Collected

Little of the collected money is retained by the judicial branch, creating little financial incentive or additional resources to increase collections.

The distribution scheme provides little financial incentive to the courts or circuit clerks to be more aggressive in collecting outstanding debts. Specifically, collecting debts does not increase resources that could be used to collect even more debts. No portion of the fines and fees collected is retained by the clerks' offices; and only 5 percent of court costs collected, up to a maximum of $2.5 million, is returned to AOC for use by circuit clerks for hiring and salary increases. Other amounts are returned for local use, but that money primarily benefits local law enforcement.

Proceeds from most fines go to the state's general fund.

Fines. After it receives the money from the circuit clerks, the Finance and Administration Cabinet distributes the money as required by statute. Proceeds from most fines are deposited in the general fund, with a few exceptions. Fines such as those for violations of fish, wildlife, boating, and littering statutes are distributed either locally or to specific funds as required by various statutes. When the circuit clerks receive payment for these specific fines, they assign those funds to the appropriate category and report them to the Finance and Administration Cabinet, which then distributes the fines to the appropriate agency or locality.

Proceeds from fees support programs relevant to the crime committed.

Fees. Fees are generally assessed by courts in connection with particular types of cases and go to support programs relevant to the crime committed. For example, the service fee for driving under the influence is $325 and is divided among several entities: the Department of Public Advocacy; the Kentucky State Police forensic laboratories; the Prosecutors Advisory Council; the

Traumatic Brain Injury Trust Fund; the Cabinet for Health and Family Services; support of jails; record keeping, treatment, and educational programs aimed at individuals who abuse alcohol; and the general fund.

Court costs of $125 must be assessed against the defendant upon conviction. Proceeds from court costs are distributed to the state and local governments, with 49 percent going to the Commonwealth general fund.

Court Costs. Court costs of $125 per case collected by the circuit clerks are sent monthly to the court cost distribution fund administered by the Finance and Administration Cabinet, which then makes monthly disbursements. House Bills 413 and 157, enacted by the 2004 General Assembly, increased court costs from $100 to $125 and specified the distribution of the additional funds. HB 413 directed that $20 of the increase go to local governments for payment of police department expenses. HB 157 allocated $5 to the Cabinet for Health and Family Services to implement and operate a behavioral-health jail triage system.

The distribution of the remaining $100 of court costs was not affected by the increase. Several programs receive shares of court costs up to a set amount. Any costs collected over the maximum amount go to the general fund (KRS 42.320). The $100 is distributed in specified percentages:

- General fund—49 percent;
- State Treasury—10.8 percent, up to $5,400,000, for the Kentucky Local Correctional Facilities Construction Authority;
- Spinal Cord and Head Injury Research Trust Fund—6.5 percent, up to $3,250,000;
- Traumatic Brain Injury Trust Fund—5.5 percent, up to $2,750,000;
- Administrative Office of the Courts—5 percent, up to $2,500,000, used by the circuit clerks to hire additional deputy clerks and enhance deputy clerks' salaries;
- Department of Public Advocacy—3.5 percent, up to $1,750,000;
- Crime Victims Compensation Fund—3.4 percent, up to $1,700,000;
- Justice Cabinet—0.7 percent, up to $350,000, to defray the costs of conducting record checks on prospective firearms purchasers pursuant to the Brady Handgun Violence Prevention Act; and to collect, test, and store DNA samples;
- Sheriff in the county in which the court cost was paid—10.1 percent, up to $5,050,000;
- Treasurer in the county in which the court cost was paid—5.5 percent, up to $2,750,000, used by the county fiscal court to defray the costs of operating the county jail and transporting prisoners (KRS 42.320).

The current collection rate is unknown, so the potential for increased collections is unknown.

An AOC official stated that the circuit clerks statewide collected more than $42 million in court costs in FY 2003. It is unknown how much collections could realistically be increased because the current collection rate is unknown; however, for the purpose of illustration, assume that the amount of costs and fines collected was increased by 10 percent. A 10 percent increase in collection of court costs would result in an additional $4.2 million for the state. Of that, $1.6 million would go to the general fund; and the remaining $2.6 million would benefit specific programs, up to the statutory maximum. A 10 percent increase in the collection of fines would bring in an additional $2.3 million per year, most of which would go to the general fund. Again, because the collection rate is unknown, it is unclear how much revenue could potentially be gained through improved collection methods.

Clerks' Offices Are Not Audited Every Year

Despite the large sums of state money they collect, circuit clerks' offices are not audited annually.

Despite the large sums of state money they collect, circuit clerks' offices are not audited annually. KRS 431.531 requires AOC to publish an annual audit of the fines and forfeitures collected by circuit clerks during the preceding fiscal year. For the past five years, AOC has contracted with private CPA firms to audit the circuit clerks on a rotating basis. AOC's goal is to audit every circuit clerk's office every four years if funds are available to do so. According to AOC officials, the costs of the audits vary, but the last audit of the Jefferson County circuit clerk's office cost nearly $50,000. Information provided by AOC indicates that 114 of the 120 circuit clerks' offices have been audited since 2000.

New Laws Affecting Collections

HB 162 and SB 228, enacted in 2004, require the judicial branch to inventory and collect outstanding debts and refer uncollected debts to the Finance and Administration Cabinet. A similar reporting requirement was also passed as part of the 2003 judicial branch appropriations bill.

During the 2004 regular session, the General Assembly enacted into law two bills that affect the debt collection practices of the executive agencies and the judicial branch: House Bill (HB) 162 and Senate Bill (SB) 228. Taken together, these bills require executive agencies and the judicial branch to inventory and collect outstanding debts and then refer those that remain to the Finance and Administration Cabinet for possible collection.

Below are the specific requirements the new laws place on the judicial branch:

- Establish and operate a system for collecting debt;
- Make every reasonable effort to collect each debt;
- Establish claims against individual income tax refunds;
- Create and maintain an ongoing inventory of debts;

- Initiate a system for tracking and identifying debts by October 1, 2004, and implement the system by October 1, 2005;
- Report annually the previous fiscal year's unliquidated debts by age, beginning October 1, 2005;
- Identify liquidated debts and submit a list of them to the Revenue Cabinet (now a department within Finance);
- Refer to Finance the debts that cabinet plans to pursue;
- Provide information about debts to the State Treasurer at the same time it is submitted to Finance;
- Maintain records of debts referred until they are collected or forgiven;
- Consider technology that could assist in the accurate, timely, and efficient delivery of debt payments in establishing the required systems; and
- Collaborate with the Justice Cabinet and Finance to implement a system to identify and collect debts in existence prior to October 1, 2005, if feasible.

A reporting requirement similar to the requirements above was also passed as part of HB 294, the 2003 judicial branch appropriations bill. The bill required the judicial branch to submit annual reports to the Interim Joint Committee on Appropriations and Revenue describing the amount and nature of uncollected court fees. As discussed above, AOC does not have the computer systems in place that will allow it to readily identify and track debts owed to the courts. A member of the Appropriations and Revenue Committee staff stated that AOC has not been reporting the information as required by the General Assembly.

It seems unlikely that AOC will be able to meet the October 1, 2004, and October 1, 2005, deadlines required by the new laws.

It seems unlikely that AOC will be able to meet the October 1, 2004, and October 1, 2005, deadlines required by the new laws. AOC officials were not able to provide a specific timeline for the development and implementation of the proposed computer systems. One portion of the program has yet to be written, and the entire system will have to be tested and then implemented in 120 counties. Full implementation is unlikely in the next two years.

Recommendation 2.2

AOC should consult with the Finance and Administration Cabinet to consider the feasibility of implementing interim policies to track and refer accounts receivable until the new computerized bookkeeping system is in place. For example, AOC could implement a policy instructing clerks to assign a 60-day review date for open cases in which bench warrants or summonses were issued and refer those with outstanding amounts to the Finance and Administration Cabinet.

Write-off Criteria

Procedures must be established to exclude from reported accounts receivable any debts that are not likely to be collected.

Once the systems are implemented and AOC can begin to track accounts receivable, its handling of older cases will affect the usefulness of accounts receivable amounts and the court system's collection rate. Since debts to the courts are intended to impose a punishment against a defendant because of illegal behavior, the court would not likely want to close a file after a certain number of years and thereby reward the defendant for eluding authorities. However, without procedures to exclude debts that are unlikely to be collected, any accounts receivable figure would be an inaccurate indication of what could be collected and would make it difficult to evaluate the courts' collection performance. Accordingly, as AOC works to implement its new systems, it should work with Finance to develop criteria to distinguish between cases that are likely collectible and those that are not, thereby allowing the uncollectible cases to remain open in the court's system but exclude them from the accounts receivable amount.

Recommendation 2.3

AOC should work with the Finance and Administration Cabinet to develop guidelines to assess the collectibility of outstanding debts so that debts reported as accounts receivable and referred for collection are debts that might realistically be collected.

Collection Methods

Bench Warrants' Effectiveness and Efficiency Questioned

A Nevada legislative report stated that bench warrants are an ineffective and expensive collection method. In Kentucky, bench warrants are essentially the only collection method used.

Kentucky's courts rely primarily on the threat of imprisonment and the issuance of bench warrants to coerce defendants to pay fines, fees, and costs. A Nevada legislative audit report found that bench warrants have limited effectiveness and are more expensive than other collection actions (State of Nevada 17). The report stated that a significant percentage of cases in which warrants were issued did not result in payment. No payment was made in 57 percent of cases with bench warrants issued for out-of-state defendants and in 35 percent of cases with in-state defendants. The report noted that using bench warrants incurs additional costs by requiring service by law enforcement, housing of arrested individuals, and transportation of any individuals arrested in another jurisdiction (State of Nevada 18). The report noted that the Nevada Judicial Collections Task Force had found the use of bench warrants was the most costly collection method available to courts and had suggested that bench warrants be used as a last resort. In Kentucky, bench warrants are essentially the only collection technique used.

Other Collection Methods Are Authorized but Are Not Used

Kentucky statutes authorize other collection methods that are not being used.

Kentucky statutes do authorize other mechanisms to collect outstanding debts. A sentencing court may issue a criminal garnishment order to recoup court costs, fees, and fines by seizing a convicted person's wages or bank accounts. Such a garnishment may also establish a claim against the estate of the defendant (KRS 532.160). Also, any unpaid criminal assessments are statutorily required to be withheld from any type of payment or transfer of money from the Commonwealth to the defendant (KRS 431.100). Debts can be withheld from any disbursement, benefit, compensation, salary, or other transfer of money.

No procedures are in place to withhold debts from payments made by the Commonwealth to the defendant or to use criminal garnishments.

These other authorized mechanisms are not routinely used, however. An AOC official stated that there is no record of criminal garnishments being used as a collection tool. Unpaid fines and costs are withheld from bail bonds posted for defendants when ordered by the court; however, no procedures are in place to allow withholding of unpaid fines, fees, and costs from any other payments the Commonwealth might make to defendants. An AOC official stated that AOC has worked with the Finance and Administration Cabinet to establish a process to seize defendants' tax refunds to pay the unpaid fines and costs, but those efforts are on hold at this time due to the passage of HB 162 and SB 228.

Recommendation 2.4

AOC officials should review the feasibility of establishing and executing criminal garnishments to collect unpaid fines, fees, and costs and should consult with Finance and Administration Cabinet officials regarding their plans to obtain and execute garnishments.

Recommendation 2.5

AOC officials should consult with the Finance and Administration Cabinet and the State Treasurer to determine the feasibility of implementing a system to allow withholding of unpaid fines, fees, and costs from state disbursements, including salaries, retirement benefits, other government benefits, and tax refunds.

Collection Practices in Other States

Other states use many collection methods that are not employed in Kentucky.

No national standard has been established to measure collection performance by state courts. Nevertheless, it is clear from a review of other states' court collection practices that many states employ methods that Kentucky does not use to collect debts. The National Center for State Courts (NCSC) reports that courts in many states began focusing on improving collections in the late 1980s and early 1990s (National Center, "Enforcement").

Tax refund intercepts can be an inexpensive and effective means to collect debts.

Tax Refund Intercepts. Intercepting an income tax refund can be an inexpensive and effective way to collect unpaid debts. NCSC reports that the Arizona Administrative Office of the Courts collected $9.5 million through tax intercepts over nine years—money that was unlikely to be recovered otherwise. In 2002, the budget allotment for the Arizona program was only $193,000, and approximately $2.1 million was recovered (National Center, "Collection"). Kentucky's courts do not use tax refund intercepts to collect unpaid debts. Officials with the Finance and Administration Cabinet stated they will use such intercepts to collect debts referred to the cabinet after the implementation of HB 162 and SB 228. It is unknown to what extent debts owed the courts will be accepted by Finance for collection under the guidelines of the new legislation.

Some states use centralized statewide judicial collection agencies that focus only on collections.

Centralized Statewide Collection Agencies. Connecticut, Rhode Island, Vermont, and Missouri have created statewide judicial collection bureaus to centralize collections for traffic violations and fines. New Hampshire and Maine have similar programs that also collect debts owed to other state agencies. According to NCSC, this system offers many advantages compared to local collection by individual courts and yields a higher collection rate because the bureau's main priority is collections (National Center, "Enforcement"). NCSC reports the collection rate in Maine is almost 90 percent. Unlike the centralized collection process created by HB 162 and SB 228, which requires referral to Finance after the defendant's failure to pay, these collection bureaus are within the judicial branch and handle collections for traffic violations from the outset of the cases.

Many defendants are able to pay court costs, fines, and fees when they appear in court but will take advantage of opportunities to delay payment.

Strategies To Avoid Delay. NCSC has identified one of the most important factors in successful collection strategies as minimizing delay between sentencing and payment. According to NCSC, many defendants are able to pay court costs, fines, and fees when they appear in court but will take advantage of opportunities to delay payment (National Center, "Collection"). Judges with full dockets do not have enough time to probe defendants' ability to pay. As a result, extended payment plans are not limited to those defendants who are truly unable to pay. NCSC has observed that if a judge sets a payment plan from the bench in open court, it not only wastes judicial time but also encourages "mass poverty" once the other defendants present realize that delaying payment is an option (Matthias 9).

Defendants are often asked if they need time to pay. Their financial situation is not verified.

This situation may be true of what is happening in Kentucky. When Program Review staff observed an area district court, the judge assessed the costs, fines, and fees and then routinely asked the defendants if they needed time to pay, regardless of whether the defendant raised the issue. The majority of defendants said they needed time to pay and were given 90 days to do so. Nothing was done to verify the defendants' financial situation. NCSC suggests that a better approach is for judges to communicate the importance of paying on the day of sentencing and to require at least a partial payment on that day if the defendant is absolutely unable to pay the full amount. This approach is used by the courts with the best collection rates and is an inexpensive way to improve collections (Matthias 33). Some courts supplement the judge's message by posting signs in the courthouse notifying defendants that payment is expected on the day of sentencing (Matthias 9).

The most successful collection systems make payment as convenient as possible by accepting checks and credit cards.

Credit Card Payments. According to NCSC, courts first began accepting credit card payments more than 10 years ago. A 2003 NCSC survey found that 77 percent of the courts responding accepted payment by credit card and that most began accepting them within the past five years. These courts include those in Georgia, California, Michigan, Florida, Louisiana, and Massachusetts. Courts that accept credit card payments report that doing so has increased both the promptness of payments and the amount actually collected (National Center, "Collection"). NCSC has observed that the most successful collection systems make payment as convenient as possible by accepting checks and credit cards (Matthias 10). Maine's judicial violations bureau accepts credit card payments online, by telephone, and in person (State of Maine).

Only one Kentucky court accepts credit cards.

Only one Kentucky court accepts payments by credit card. Finance officials stated that they have discussed credit card acceptance with AOC officials but some time has elapsed since the discussions took place. No statewide system has been implemented for the judicial branch. Finance will accept credit card payments for the debts it collects, but debts are not likely to be referred to the cabinet until a considerable time has passed. The cabinet may not attempt to collect debts if officials consider them too small. Acceptance of credit card payments by Kentucky courts could immediately boost both the promptness of payments and the amount collected without the necessity of delay and referral of the debt to Finance. Because more money could be deposited in the state's bank account more quickly, the state could gain additional revenue and interest.

Recommendation 2.6

AOC officials should consult with Finance and Administration Cabinet officials regarding the acceptance of credit card payments and should then take the necessary steps to enable circuit clerks' offices to accept credit card payments for costs, fees, and fines. AOC officials should also consider the feasibility of adding credit card payment capability to the Court of Justice Web site.

Some states use collection investigators who interview and screen defendants who request time to pay.

Collection Investigator Programs. State courts in Colorado, Arizona, and Missouri employ collection investigators as extensions of court clerks' offices (Matthias 33). The programs require a defendant requesting time to pay to complete a financial affidavit. The investigator verifies the information through an interview with the defendant and through calls to references before the defendant leaves the courthouse. The investigator compares the

financial data to income guidelines and determines whether the defendant is able to pay at that time or qualifies for additional time. If a payment plan is ordered, the defendant is given a copy of the plan before leaving the courthouse. The court monitors the plan and promptly responds to missed payments with a call or letter. According to NCSC, collection investigator programs often pay for themselves through increased revenue (National Center, "Collection"). Colorado's program, which has been in existence since 1988, collects $8 to $10 for every dollar spent (Matthias 11). The programs also save court time by relieving judges of the need to deliberate over payment terms and defendants' finances during court proceedings.

Additional collection methods used by other states could be considered.

Additional Methods. Additional methods used by other states include

- sending letters and making telephone calls to delinquent debtors,
- charging late fees or interest,
- threatening to report delinquent debtors to credit reporting agencies,
- using property liens and garnishments,
- hiring private collection agencies, and
- exchanging information with other courts and government agencies to locate delinquent debtors (Matthias).

AOC Should Consider Implementing Additional Collection Techniques

SB 228 requires the judicial branch to establish and operate a system for collecting debt.

Although several of the methods used by courts in other states will be used by the Finance and Administration Cabinet when it begins its centralized collection efforts, AOC itself should be encouraged to implement additional collection methods and improve its effectiveness. SB 228 requires the judicial branch to establish and operate a system for collecting debt.

Implementing additional collection methods could minimize the delay between sentencing and payment and could increase collections.

One of the most important collection strategies is the reduction of delay between sentencing and payment, but Kentucky courts may allow a defendant to take up to a year to pay a debt (KRS 23A.205(3); KRS 24A.175(4)). HB 162 provides that such debts will not be referred to the Finance and Administration Cabinet until after the time allowed for payment by a court has elapsed. If the courts adopt such practices as accepting credit card payments, communicating a serious attitude toward prompt payment, requiring at least a partial payment on the day of sentencing, and obtaining payment information from defendants when they are before the court, it could shorten the time between sentencing and

payment and ultimately increase collections. Any debts that were not collected would still be referred to the Finance and Administration Cabinet as mandated by HB 162 and SB 228.

The courts should adopt additional internal collection procedures in light of the new statutory requirements and the expected delay in implementing an accounts receivable system.

Additionally, HB 162 requires the Finance and Administration Cabinet to pursue collection of only those debts that are cost-effective to pursue. Cabinet officials have not yet determined a dollar threshold for debts the cabinet will pursue, but many debts owed the courts may be too small for the cabinet to collect in a cost-effective manner. Also, in light of the length of time it will take for AOC to develop and implement an accounts receivable system that will enable the judicial branch to comply with the debt referral provisions of HB 162 and SB 228, it would be more efficient for the courts to adopt additional internal collection procedures that could be implemented more quickly.

A weak enforcement and collection system can erode respect for the courts and provide little incentive to defendants not to offend again.

A weak enforcement and collection system also incurs potentially significant intangible costs in terms of damage to the standing of the courts. Such a system clearly reduces revenue to the Commonwealth, but it also erodes respect for the courts and provides little incentive to defendants not to commit offenses again. NCSC has observed that the authority and integrity of the courts are called into question by unenforced court orders and the resulting unpaid fines and fees (Matthias 2). A failure to enforce fines for lesser offenses sends a message to defendants that the consequences of breaking the law are minor and leads to a community perception of lax enforcement (Matthias 2, 37). In turn, this situation can lead to an increasing criminal caseload, making it even more difficult to devote the time and resources to collection actions. Alternatively, a strong collection program can deter defendants from attempting to avoid payment by creating a perception in the community that the court system is able and willing to enforce court orders and to collect amounts owed.

For all of these reasons, it is important for the judicial branch to take the steps necessary to assess the status and amount of the debts owed to it, to assess the effectiveness of its collection practices, and to implement additional collection practices as indicated.

Recommendation 2.7

AOC officials should study other states' best practices in collection systems and determine which systems and methods would best suit Kentucky's needs.

Recommendation 2.8

AOC officials should consult with Finance and Administration Cabinet officials and develop a strategic plan to collect debts owed to the judicial branch. The plan should include which collection methods the courts will adopt, a means of prioritizing debts for collection, and a proposed performance measure that takes into account the proportion of debt that might realistically be collected.

Chapter 3

Medicaid: Procedures Can Be Improved for Preventing Improper Payments and Collecting Debts

Medicaid is at high risk for making improper payments and failing to collect debts.

Kentucky's Medicaid program is at high risk for making improper payments. Improper payments include inadvertent errors, such as duplicate payments and calculation errors; payments for unsupported or inadequately supported claims; payments for services not actually received by Medicaid recipients or rendered to ineligible recipients; and payments resulting from outright fraud and abuse.

Medicaid is also at high risk for failing to collect debts. Payments on behalf of ineligible recipients are difficult or impossible to recover because they are likely to be poor and thus have few resources from which to repay the state. Debts arising from fraudulent claims from providers and fraudulent practices in the drug rebate program are difficult to identify.

Medicaid debt totaled 96 percent of statewide noncurrent receivables as of FY 2003. Most was attributable to hospital cost report settlements.

As of the end of FY 2003, Medicaid reported $95 million in noncurrent accounts receivable, which are debts that are not expected to be collected in the near term. Medicaid's debt equaled 96 percent of statewide noncurrent receivables. Most of the noncurrent receivable balance was attributable to hospital cost report settlements. Medicaid estimated that $75 million of the total was likely to be collected, and $20 million was probably uncollectible. Most of the uncollectible amount was attributable to disputed drug rebate invoices.

This chapter describes some of the actions taken by Medicaid in recent years that have saved money and makes recommendations for further improvement.

This chapter describes some of the actions taken by Medicaid in recent years that have saved money. Because there is still room for improvement, this chapter makes recommendations to (a) consider strengthening the Cabinet for Health and Family Services' (CHFS) ability to identify other parties that may be liable for health care costs paid by Medicaid, (b) implement a stronger control system to prevent ineligible persons from obtaining benefits, (c) strengthen the role of the CHFS Inspector General, (d) actively try to collect drug rebates and interest, (e) monitor interest due on all drug rebate receivables, and (f) resolve disputed drug rebate receivables.

Medicaid Spending Has Increased Significantly

Medicaid spends about $1.2 billion in state funds each year. A 1 percent decrease in Medicaid expenditures would save the state $12 million.

Kentucky's Medicaid program spends approximately $1.2 billion in state funds each year, about two-thirds of which is from the general fund. The sheer size of Medicaid expenditures merits serious consideration of state payments and collections. A 1 percent decrease in Medicaid expenditures would save the state $12 million a year. Rapid growth in the program means Medicaid will only increase in importance as a share of the state budget.

The federal government pays 70 percent of the cost of Medicaid claims; the state pays 30 percent.

The federal government pays approximately 70 percent of the cost of Medicaid benefit claims; the Commonwealth pays the remaining 30 percent.[1] The state share of Medicaid expenditures increased from $259 million in FY 1990 to $1.2 billion in FY 2003. The state share of the average cost per recipient increased from about $65 to $149, and the average number of monthly recipients increased from just under 370,000 to more than 650,000 in that period.

Each state's Medicaid officials must carefully manage processes for holding down costs and for collecting debts while ensuring that eligible persons receive the benefits to which they are entitled. Health care costs continue to rise across the board. Kentucky's Medicaid pharmacy costs alone have increased almost 350 percent from 1992 to 2003—more than 10 times the overall inflation rate. The state share of pharmacy costs in FY 2003 was $200 million. Some part of the increased state spending can be attributed to a lack of action to prevent improper payments and collect debts owed the state, as well as incidents of fraud.

Medicaid has a financial incentive to prevent overpayments to providers and to recover such payments when they are discovered.

The Medicaid program has a financial incentive to prevent overpayments to providers. Medicaid also has a financial incentive to recover such payments when they are discovered. The state ultimately pays for 100 percent of the medical service rendered but gets to keep 100 percent of a recovery of an overpayment. This critical fact is sometimes misunderstood. When a provider claim is paid, the U.S. Centers for Medicare and Medicaid Services (CMS) pays 70 percent and the state pays 30 percent. If the state later discovers that the claim was improperly paid, the state sets up an account receivable and reports it to the federal government. CMS then withholds the 70 percent federal share from a future payment to the state, regardless of whether the state has collected the receivable. Since the provider has already been paid and CMS has recouped its share of the original payment, the result is that the

[1] In this chapter, the state's share of collections and payments associated with benefits is consistently estimated at 30 percent. The actual percentage varies somewhat from year to year.

state has paid 100 percent of the claim. This means that 100 percent of the amount is an account receivable for the state. When the receivable is collected from the provider, the state retains the entire amount.

The federal government participates in the cost of overpayment debts that are written off as uncollectible in accordance with federal guidelines.

If a Medicaid debt that has been reported as a receivable to CMS is later determined to be uncollectible in accordance with CMS guidelines, the state writes off the receivable and reports it to the federal government. CMS then reimburses the state for the 70 percent federal share previously withheld. In other words, the federal government participates in the cost of overpayment of debts that are written off as uncollectible. Determining the collectibility of reported receivables and writing them off when uncollectible can gain increased federal funding for the state.

Preventing and Collecting Improper Payments

Kentucky's Medicaid program has recently focused its efforts on preventing improper payments.

In the past, Kentucky's Medicaid program has focused on recovering improper payments rather than cost avoidance—preventing the improper payments in the first place. Medicaid has increased its efforts to prevent improper payments and has demonstrated significant improvement in this area. Cost avoidance is a Medicaid success story that can be made even more successful.

Preventing improper payments represents additional value to the state because it pays less in administrative costs and can earn additional investment income.

CMS uses state-reported data to monitor and evaluate the effectiveness of states' cost avoidance and collection activities. CMS prefers that states prevent improper payments instead of paying and then trying to collect an overpayment. While preventing improper payments decreases collection totals, it represents additional value because the state's administrative expenses are reduced. In addition, the state keeps its money in the bank, which increases interest income or the funds available for other purposes.

Third-party Liability

Third-party liability is the legal obligation of other entities such as Medicare or private insurers to pay the cost of medical services rendered to Medicaid recipients.

Third-party liability refers to the legal obligation of third parties to pay all or part of the cost of medical services rendered to Medicaid recipients. Under federal law, the Medicaid program is the payer of last resort. All other available third-party resources must meet their legal obligations to pay claims before the Medicaid program will pay for the care of an eligible individual. Common sources of third-party payments include Medicare, private health insurance, court judgments, estate recoveries, and medical support from noncustodial parents.

Two contractors perform Kentucky's third-party liability function to prevent and collect improper payments.

Federal law requires that each state have a cost-effective third-party liability function to prevent and collect improper payments. Two contractors, Unisys and Public Consulting Group, perform Kentucky's third-party liability function. The casualty and estate recovery functions were transferred from Medicaid's Program Integrity Division to Public Consulting Group in 2004.

Medicaid is required to reject claims that may be payable by a third party. In FY 2002, Medicaid saved almost 60 times more by preventing improper payments than it collected in overpayments.

Cost Avoidance. Medicaid is required to reject claims that may be payable by a third party. Medicaid has made improvements in preventing improper payments through the third-party liability function in recent years. In FY 2002, Medicaid saved almost 60 times more by preventing improper payments than it collected in overpayments. Table 3.1 shows that the state share of Medicaid dollars collected after overpayments were made has remained steady through FY 2002 at an average of $3 million annually. Cost avoidance has increased significantly, with a peak of more than $240 million of state dollars saved in FY 2000.

Table 3.1
State Share of Third-party Liability Collections and Cost Avoidance Savings (in millions of dollars)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Cost Avoidance	$61.4	$130.3	$240.1	$168.3	$190.9
Collections	$3.2	$2.8	$2.8	$3.4	$3.2
Total (in $ millions)	$64.6	$133.1	$242.9	$171.7	$194.1

Note: The state share equals 30 percent of total collections and cost avoidance.
FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using data obtained from the U.S. Centers for Medicare and Medicaid Services.

In FY 2002, Medicaid avoided paying almost $180 million in state funds on behalf of Medicare-eligible persons.

Table 3.2 shows that most cost avoidance is due to payments on behalf of Medicare-eligible individuals: almost $180 million in FY 2002, for example. One reason Medicare is the most significant category in cost avoidance is the ready availability of Medicare eligibility data from the federal government. Another reason is that persons who are covered by both Medicare and Medicaid are often the most elderly, infirm, and costly group. Medicaid also avoided paying approximately $11 million in state funds in FY 2002 due to the liability of private health insurance companies.

Table 3.2
Components of the State Share of Third-party Liability Cost Avoidance
(in millions of dollars)

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Medicare	$60.1	$123.4	$227.1	$159.2	$179.7
Private Health Insurance	$1.3	$6.9	$13.0	$9.1	$11.2
Total (in $ millions)	$61.4	$130.3	$240.1	$168.3	$190.9

Note: The state share equals 30 percent of total cost avoided.
FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using data obtained from the U.S. Centers for Medicare and Medicaid Services.

Matching electronic data with eligibility files of other insurance companies is necessary to prevent improper payments when a third party is liable. Medicaid officials stated that private insurance companies have improved in providing the necessary data to enable Medicaid to prevent improper payments, but Medicaid does not have files of all the insurers serving the state.

Kentucky's statute for data matching is insufficient to ensure that Medicaid is able to discover third-party coverage by private insurers.

Kentucky's relevant statute (KRS 205.623) is insufficient to ensure that Medicaid is able to maximize its ability to discover third-party coverage through matching of electronic data with the eligibility files of all insurers. According to statute, insurance companies must provide, upon request to the Cabinet for Health and Family Services coverage information and data on claims paid to Medicaid-eligible policyholders and dependents. This information is to be sent electronically in the format prescribed by the cabinet. However, the statute provides no penalty for not complying with the cabinet's request. Cabinet officials stated that draft legislation to strengthen the statute has been considered previously.

Recommendation 3.1

To maximize Medicaid's ability to avoid paying claims that are the responsibility of a liable third party, the General Assembly may wish to consider amending KRS 205.623 to include a penalty for noncompliance.

If a claim is paid and a liable third party is later found, Medicaid collects from the third party.

Collections. If Medicaid learns of the existence of a liable third party after a claim is paid or if benefits become available from a third party after a claim is paid, Medicaid must seek recovery from the third party. When Medicaid receives the recovery, the state keeps 100 percent of the money. CMS will withhold its share from future payments to the state.

Third-party collections are categorized by CMS as private health insurance, casualty, estate recovery, or Medicare. Each category is explained below.

- *Private health insurance*. If private insurance is available to a recipient and Medicaid has paid a claim that may be covered by the insurance, Medicaid must file for reimbursement from the insurance company. Medicaid also uses the cost avoidance approach by matching data with private insurance companies before paying the claims to prevent erroneous payments.
- *Casualty*. If a Medicaid recipient is injured in an accident or through the actions of another person, Medicaid is required to seek reimbursement from any potentially liable third party. This category most commonly includes automobile insurance, homeowner's insurance, and potentially liable companies or negligent individuals.
- *Estate recovery*. Medicaid is required to collect from the estate of a deceased recipient the amounts paid on the individual's behalf for nursing facility services, home- and community-based services, and related hospital and prescription drug services.
- *Medicare*. If a Medicaid recipient is also eligible for Medicare, the Medicare program is liable for the costs of that recipient's hospital and physician services up to the limit of Medicare's coverage. Medicaid is the payer of last resort, so Medicare is considered a liable third party.

The majority of third-party collections is from private insurance. The majority of avoided costs is from Medicare.

Private health insurance makes up the majority of third-party collections. Table 3.3 shows that in 2002 Medicaid collected and retained almost $2 million from private health insurance companies. Medicaid began estate recoveries in 1994 and increased the state money collected to almost $600,000 in FY 2002. Medicare has been the least significant source of third-party liability collection. In FY 2002, Medicaid collected and retained approximately $111,000 due to Medicare eligibility. One reason for the low collection level is Medicaid's success in preventing payment of claims that are the responsibility of Medicare.

Table 3.3
Components of State Share of Third-party Liability Collections

	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Private Health Insurance	$2,430,155	$2,269,704	$1,813,771	$2,050,833	$1,711,402
Casualty	$802,515	$493,518	$787,532	$907,886	$799,154
Estate Recovery	$0	$0	$169,599	$414,856	$568,144
Medicare	$4,682	$29,869	$17,289	$1,201	$111,365
Total	$3,237,351	$2,793,091	$2,788,191	$3,374,776	$3,190,066

Note: The state share equals 30 percent of total collections. Categories may not add to exact total shown due to rounding. FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using data obtained from the U.S. Centers for Medicare and Medicaid Services.

Detecting Errors and Fraud in the Medicaid Program

Controls are necessary to prevent errors and fraud and to detect them when they occur.

Controls are necessary to prevent errors and fraud and to detect them when they occur. Edits and audits in Medicaid's computerized claims-processing system help detect provider errors and fraud. Kentucky's Attorney General plays a significant role in criminally prosecuting recipients, caseworkers, providers, and pharmaceutical companies found to have defrauded the Medicaid program.

Edits and Audits

The Medicaid Management Information System reviews claims for errors and fraud.

Federal law requires a Medicaid Management Information System (MMIS), a computerized claims processing and information retrieval system for state Medicaid programs. MMIS is an integrated group of procedures and computer-processing operations developed to meet principal objectives, including the review of claims for errors and fraud before the claims are paid. Kentucky contracts with Unisys to operate the state's system.

Claims that are flagged during screening are either suspended or denied.

Edit and audit functions screen claims against recipient and provider eligibility data; claims history; and procedure, drug, and diagnosis information. Edits check the validity of a claim. Audits check claims history to see if the procedure has been billed before. Edits and audits are intended to prevent invalid and duplicate claims from being paid. Claims flagged during the edit and audit screening are either suspended or denied, thus preventing potential improper payments. Suspended claims enter an online claims resolution process to ensure that the necessary information is obtained to correctly process or deny the claim.

A private CPA firm is contracted to perform a systems audit of Kentucky's MMIS each year. The audit for the period July 1, 2002,

to June 30, 2003, found that controls were properly designed and operating effectively. Sometimes, however, Medicaid authorizes an edit or audit to be deactivated. For example, an edit for prior authorization of home health services was deactivated in February 2002 because many claims were denied inappropriately. The edit was not reactivated until January 2004.

When an edit or audit is deactivated, Medicaid should correct the problem as soon as possible to prevent paying claims that should have been denied or suspended. If not prevented, Medicaid has to go through the expense and effort of recovering improper payments from the providers, and the Commonwealth may lose investment income on the money paid.

A contingency fee contractor collects payments that should not have been made.

When a Medicaid claim is paid erroneously, even after being screened by edits and audits, the money should be recovered from the provider. Medicaid contracts with Myers and Stauffer, on a contingency fee basis, to identify and collect Medicaid payments determined to be erroneous or fraudulent.

Ineligible Recipients

Medicaid also risks paying benefits on behalf of ineligible recipients.

Medicaid also risks paying benefits on behalf of ineligible recipients. Ineligible persons can get medical services in at least four ways: agency error in determining eligibility, applicant error in providing information regarding eligibility, intentional misrepresentation of information by applicants to obtain benefits, and ineligible persons using eligible persons' medical cards.

Staff who determine eligibility do not have the resources or training to conduct investigations.

Medicaid eligibility is determined at local Department for Community Based Services (DCBS) offices. DCBS staff do not have the resources or training to conduct field investigations to verify eligibility data, even when they have a strong belief that a client has presented inaccurate information.

An Investigative Program Was Discontinued

An investigative program, the Cooperative Review of Eligibility (CORE), was discontinued in FY 2003.

The Cooperative Review of Eligibility (CORE) investigative program, operated by the Cabinet for Health and Family Services Office of the Inspector General, was discontinued in the first quarter of FY 2003. This finding was first reported in Program Review's 2004 report on the Kentucky Transitional Assistance Program (K-TAP). CORE's function was to perform field investigations to prevent people from fraudulently obtaining benefits in the Medicaid, K-TAP, Food Stamps, and other public benefit programs.

CORE began in 1986 as a pilot project with one part-time investigator in Fayette County. By 1996, it had expanded to include three investigators in 10 counties. A Program Review report issued in 1995 recommended expanding investigative programs like CORE. The caseworkers interviewed for that report generally indicated satisfaction with it. Caseworkers in areas not served by CORE said they felt such a program could be useful.

The CHFS Inspector General indicates that CORE produced cost savings.

In response to an inquiry by Program Review staff, the CHFS Inspector General indicated that CORE resulted in cost savings. The Inspector General stated that investigators completed more than 3,400 investigations between FY 1997 and FY 2003. He estimated that these investigations identified $6.6 million in improper payments in public benefit programs, including both state and federal funding. Most of the improper payments were identified quickly enough to be prevented.

As initially recommended in the 2004 Program Review report on K-TAP, CHFS should consider reviving CORE or a similar program, depending on the results of a cost-benefit analysis. Even if the program is revenue neutral, it could serve to deter individuals who might otherwise attempt to take advantage of public assistance programs by presenting false or inaccurate information, which would result in additional savings to the state.[2]

Recommendation 3.2

The Cabinet for Health and Family Services should review the feasibility of establishing a field-based investigation unit such as the Cooperative Review of Eligibility program. The review should include a cost-benefit analysis. The results of the analysis and any actions taken to expand the capability of the Office of Inspector General to conduct field investigations should be reported to the Program Review and Investigations Committee before the 2005 session of the General Assembly.

The Office of the Inspector General

The Inspector General is required to conduct audits and investigations to detect fraud or abuse by recipients and providers.

The CHFS Office of the Inspector General is required by KRS 194A.030(5) to conduct audits and investigations to detect fraud or abuse by recipients and providers. The Inspector General operates a fraud and abuse hotline and seeks recoveries from providers and recipients. The Inspector General indicated that the related

[2] Recommendation 3.2 is identical to Recommendation 2.4 in Program Review's 2004 K-TAP report.

functions of the office are being reorganized and expanded into three divisions.

The Division of Fraud, Waste and Abuse/Identification and Prevention is a new unit in the Inspector General's Office. It consists principally of Medicaid's former program integrity function and is expected to

- conduct surveillance and utilization review of providers and recipients, including payment edits and administrative recoveries;
- coordinate fraud and abuse investigations by the Inspector General and law enforcement;
- perform specialized recovery and cost avoidance functions, including Medicaid's accounts receivable and third-party liability functions; and
- use the Kentucky All-Schedule Prescription Electronic Reporting database to monitor prescription drug use. (Appendix B describes two laws passed by the 2004 General Assembly to help state officials monitor and control drug use in the Commonwealth.)

The Division of Special Investigations is expected to

- revive and expand the CORE program;
- conduct preliminary investigations of Medicaid provider fraud and abuse, such as upcoding of procedures, billing for services not rendered, and billing twice for the same procedure; and
- perform field investigations of potential fraud in public assistance programs.

The Division of Audits is expected to

- audit contractors for compliance with contract terms, laws, and regulations;
- conduct performance audits to improve accountability and operational effectiveness;
- expand the review of cabinet monitoring activities; and
- perform internal audit functions to protect state funds.

These expanded activities, when fully in place, should help ensure the integrity of Medicaid and related public benefit programs administered by the Cabinet for Health and Family Services.

Recommendation 3.3

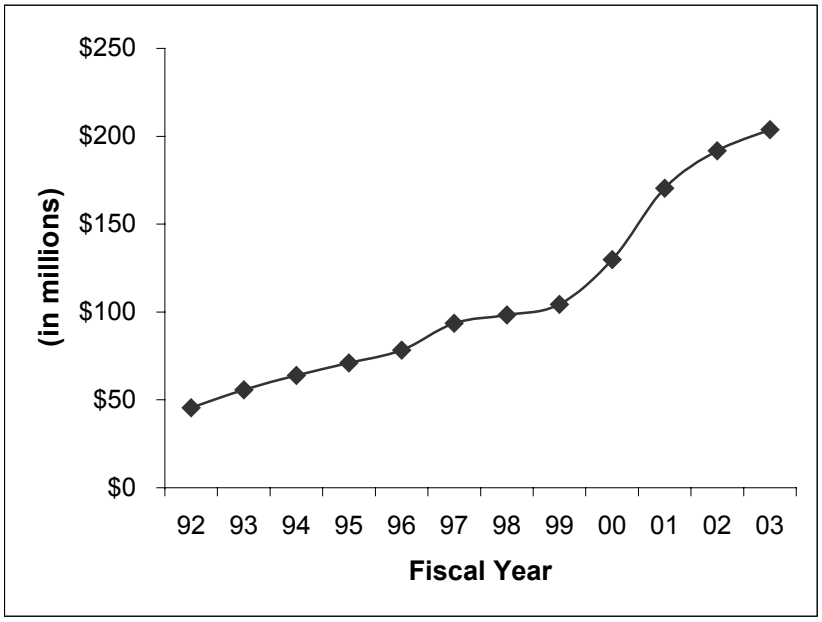
The CHFS Inspector General should implement the planned expansion of audit and investigative functions and ensure the financial integrity of public benefit programs administered by the cabinet. The Inspector General should develop a method to report the results of audits and investigations. The Office of Inspector General should report to the Program Review and Investigations Committee before the 2005 session of the General Assembly all actions taken to strengthen the audit and investigative functions of the cabinet.

Medicaid's Prescription Drug Costs

Increased Medicaid spending is driven in part by increased spending for prescription drugs.

Medicaid spending in all states has risen dramatically in the past decade, driven in part by increased spending for prescription drugs. Drug costs must be contained and fraud must be eliminated whenever possible. Kentucky's share of Medicaid pharmacy expenditures has increased from approximately $50 million in FY 1992 to more than $200 million in FY 2002, as illustrated in Figure 3.A.

Figure 3.A
Kentucky's Share of Medicaid Pharmacy Expenditures
(FY 1992 to FY 2003)



Note: The state share equals 30 percent of total expenditures.
FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using data obtained from the U.S. Centers for Medicare and Medicaid Services.

In 2001, Kentucky's Medicaid recipients had an average of 23 prescriptions each compared to a national average of 12 (Ward). Those prescriptions cost an average of almost $89 per recipient each month; the national average was $52 a month, including both state and federal shares of the cost. Kentucky's share of the cost of each prescription is $26.70.

Kentucky's Medicaid program has taken steps to contain pharmacy costs, and additional steps are planned.

Kentucky's Medicaid program has taken steps in recent years to control pharmacy costs, and additional steps are planned. Measures that Medicaid already uses to contain pharmacy costs are described in Appendix B. The increase in Medicaid expenditures and the recent decrease in state revenues have led states to focus on collecting noncurrent receivables. An area in which Kentucky's Medicaid program can improve collections of noncurrent accounts receivable is the drug rebate program.

Medicaid's Drug Rebate Program

More than 500 drug manufacturers participate in the Medicaid Drug Rebate Program.

The Medicaid Drug Rebate Program requires drug manufacturers to enter into a legally binding agreement with the U.S. Department of Health and Human Services before they can receive federal funding for outpatient drugs dispensed to Medicaid recipients. More than 500 drug manufacturers participate.

The rebate program was implemented in 1991 in response to concerns that Medicaid was paying more for outpatient drugs than other large purchasers. The program requires drug manufacturers to provide rebates to participating state Medicaid agencies. In return, states must cover all prescription drugs manufactured by participating pharmaceutical companies.

The Centers for Medicare and Medicaid Services calculates the unit rebate amount and provides the information to the states.

CMS calculates the unit rebate amount from data provided by drug manufacturers and provides the information to the state Medicaid agencies each quarter.[3] As a result, the drug rebate process includes a built-in delay in collecting amounts owed the state that is beyond the control of Kentucky's Medicaid Department. The process for calculating the amount of rebate owed the state and the formula used to calculate the unit rebate amount are detailed in Appendix C.

Medicaid's fiscal agent, Unisys, applies the unit rebate amounts to the number of Medicaid units dispensed from the state's retail pharmacies to calculate the rebates due to the state. The collection

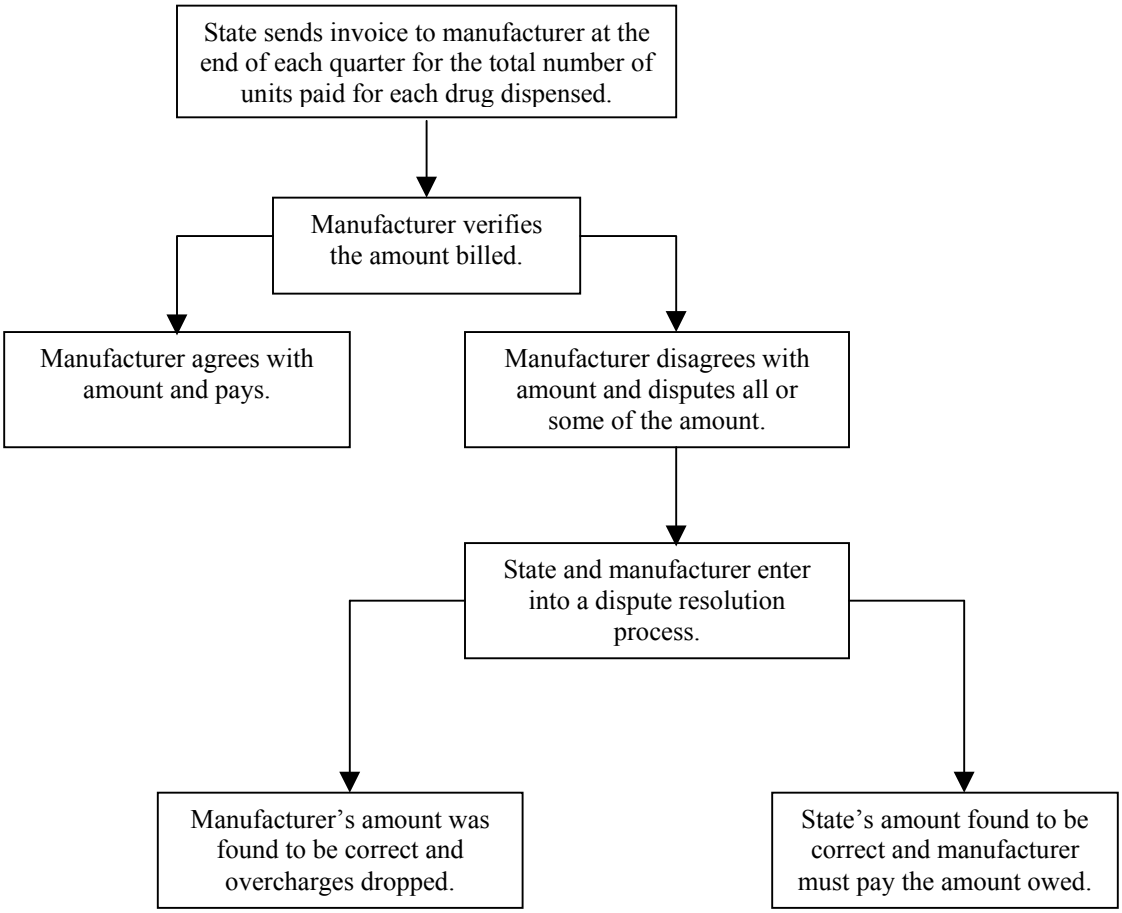
[3] The definition of unit depends on the drug. For example, it would mean each for pills or capsules, a unit of volume such as milliliter for liquids, and a unit of weight such as gram for powders (State of Indiana 2).

process shown in Figure 3.B begins when Unisys sends invoices to the drug manufacturers.

If a manufacturer disputes a billed amount, it is not required to pay until the dispute is settled.

If a drug manufacturer disputes a billed amount, the state and the manufacturer enter into a resolution process. Until the correct amount owed the state is resolved, the manufacturer is not required to pay the disputed amount.

Figure 3.B
Medicaid's Drug Rebate Collection Process



Source: Anthony Farino, "Pharmaceutical Pricing Explained."

The drug rebate agreement requires Medicaid to rely on manufacturers to calculate and pay interest on late payments.

If Medicaid does not receive a payment from a drug manufacturer within 38 days, it sends the manufacturer a delinquent notice. Another notice is sent after 60 days to request payment or the reason for any disputed amount. Medicaid does not include interest charges on delinquent drug rebate receivables. Instead, Medicaid depends on the manufacturers to calculate and pay interest. As a result, the state could be losing interest income on outstanding drug rebate receivables.

Kentucky's State Auditor reports that Medicaid has not actively sought payment after a second delinquent notice has been sent.

In a 2004 letter to CHFS, the Kentucky State Auditor reported that Medicaid has not been actively seeking payment on accounts receivable after a second delinquent notice has been sent. According to federal officials, Kentucky had $28 million in drug rebate receivables outstanding for more than 90 days as of June 30, 2002. It is important for Medicaid to continue attempts to collect outstanding drug rebate amounts.

Recommendation 3.4

Medicaid should actively try to collect all drug rebates and interest owed by all pharmaceutical companies, including current and backlogged amounts.

Recommendation 3.5

Medicaid should monitor interest charges on all invoices to drug manufacturers. When an invoice remains unpaid, interest charges should be assessed on the outstanding balance from the due date.

Recommendation 3.6

Medicaid should resolve disputed amounts in the backlog of drug rebate receivables. If the backlogged amounts are not collectible, they should be removed from the receivable balance to enable Medicaid to concentrate on collectible amounts due.

Reporting Drug Rebate Collections

The state is required to report rebate collections to CMS quarterly. Drug rebates are considered a reduction of pharmacy expenditures. The rebate data are used to determine the state's overall quarterly pharmacy expenditures. The state retains 100 percent of state collections, and CMS withholds the 70 percent federal share from

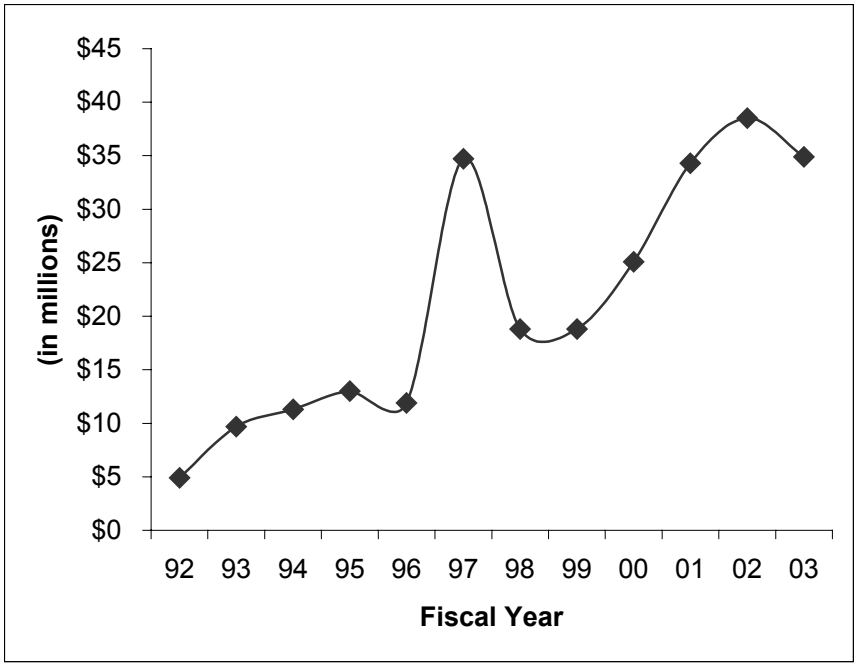
future payments to the state. The sooner the state collects the rebate, the sooner the state earns interest on the deposit.

Kentucky's Medicaid drug rebate collections have fluctuated over the years but have generally increased in the past 10 years.

Kentucky's Medicaid drug rebate collections have fluctuated but have generally increased in the past 10 years. In federal fiscal year 2003, the state share of drug rebate collections was approximately $35 million. According to Health and Family Service Cabinet officials, the state share of collections for state fiscal year 2004 is approximately $43 million. Figure 3.C shows that collections spiked between FY 1996 and FY 1997 when Medicaid contracted out the collection process. The contractor resolved some but not all backlogged disputes with drug manufacturers.

A precise year-to-year comparison of rebate collections and pharmacy expenditures is not valid because of delays in receiving the required information from CMS, sending out bills to drug manufacturers, and resolving disputed amounts. The overall trend in collections, as shown in Figure 3.C, is consistent with the trend in pharmacy costs as shown in Figure 3.A.

Figure 3.C
State Share of Medicaid Drug Rebate Collections
(FY 1992 to FY 2003)



Note: The state share equals 30 percent of total collections.
FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using data obtained from the U.S. Centers for Medicare and Medicaid Services.

Federal Audits of Drug Rebate Receivables

The U.S. Department of Health and Human Services (HHS) Inspector General has audited each state's drug rebate program. The purpose of the audits was to identify uncollected rebates, evaluate accountability and internal controls over rebate policies, and review state procedures for resolving rebate disputes between Medicaid and drug manufacturers.

Federal auditors reported a drug rebate receivable balance for Kentucky of $28 million that had been outstanding for more than 90 days.

The HHS Inspector General audited Kentucky's drug rebate program from March through May 2003. The auditors found a significant drug rebate receivable balance of approximately $35 million as of June 30, 2002, which includes the state and federal shares. Nearly $28 million of the balance was outstanding for more than 90 days—much of it for several years. In a June 8, 2004, email from the CMS regional office in Atlanta, federal officials expressed concerns about Kentucky's collection and reporting of drug rebates. Unpaid rebates are classified as disputed amounts, which must be resolved with drug manufacturers for Medicaid to collect or write off the receivables.

CHFS officials assert that many disputed amounts are not collectible.

CHFS officials have said that not all disputed amounts included in accounts receivable are collectible. They assert that the receivables were calculated on the basis of faulty information entered into the system years ago. When the drug rebate program began, the unit rebate amount provided by CMS was sometimes overstated. Also, data entry errors were made, such as typing 500 instead of 50 units of a dispensed drug. In both situations, the drug companies have disputed the billed amounts. Medicaid officials stated that only one staff person is assigned to resolving drug rebate disputes, so Medicaid has been limited in what it can accomplish.

Medicaid Is Seeking a Pharmacy Benefits Manager

Medicaid is seeking a pharmacy benefits manager to manage all pharmacy-related functions, including drug rebate dispute resolution functions, collecting receivables, and calculating interest due on overdue payments.

Many states have recently contracted with organizations to manage pharmacy benefits. Medicaid is seeking a pharmacy benefits manager to manage all pharmacy-related functions. The manager is expected to implement all dispute resolution functions that are part of the drug rebate program, including, but not limited to, researching and resolving discrepancies between Medicaid and manufacturer records, collecting receivables, and calculating interest due on overdue payments in accordance with CMS guidelines. Program Review staff would have recommended more resources for Medicaid to resolve the outstanding drug rebate balance if a pharmacy benefits manager were not being hired.

Vermont estimates savings of 10 to 15 percent of pharmacy costs by using a pharmacy benefits manager (National Governors Association, "Addendum" 5). If Kentucky could save 10 percent, the state's share would be more than $20 million.

Supplemental Drug Rebates

States may negotiate with drug manufacturers to receive supplemental drug rebates in addition to the federally mandated rebates.

States may negotiate with drug manufacturers to receive supplemental drug rebates in addition to the federally mandated rebates. Drug manufacturers may agree to provide states with supplemental rebates in exchange for including their drugs on a preferred drug list. States promote preferred drugs by requiring prior authorization for nonpreferred drugs. Prior authorization requests are generally granted, but the process itself is designed to deter physicians from making requests unless the nonpreferred drug is medically necessary.

The National Governors Association estimates likely savings of 10 to 15 percent from supplemental drug rebates and better management of pharmacy benefits.

The National Governors Association estimates that states are likely to see savings of 10 to 15 percent from supplemental rebates and better management of pharmacy benefits (National Governors Association, "States"). Kentucky's Medicaid program contracts with Provider Synergies to negotiate supplemental rebates. The exact amount of Kentucky's potential savings cannot be determined.

Kentucky Attorney General's Investigations of Benefit Recipients and Caseworkers

The Attorney General's Special Investigations Division investigates and prosecutes recipients and caseworkers found to have defrauded benefit programs.

A program such as CORE could prevent individuals from fraudulently obtaining benefits. Other activities of the CHFS Inspector General include administrative pursuit of recoveries and referral to prosecuting authorities of possible criminal violations. The Kentucky Attorney General's Special Investigations Division investigates and prosecutes recipients and caseworkers found to have defrauded benefit programs such as K-TAP, Food Stamps, and Medicaid. Criminal prosecutions by the division may deter people who would consider defrauding public benefit programs.

Kentucky's Attorney General began conducting welfare fraud criminal investigations in 1980. The Special Investigations Division receives referrals for investigations from CHFS. The division's contract with the cabinet has limited cases to those in which the alleged fraud exceeded a specified dollar threshold. The CHFS Inspector General stated that this threshold will not be part of future agreements with the Attorney General's Office.

The division's contract with CHFS has also limited the caseload to 210 cases per year since FY 2003.[4] Prior to this cap, the number of cases exceeded 700. Since deadlines had to be met in each case, the division and CHFS agreed on the caseload cap. However, the CHFS Inspector General stated that the caseload cap will not be included in future agreements. More investigations could be conducted if more resources were available.

The investigators establish a case and forward it to prosecutors. Officials with the division are not responsible for collecting fees, fines, or restitution ordered as a result of their investigation. Table 3.4 shows the total adjudicated dollar amount ordered from cases the division investigated and referred for prosecution. The uncollected amount is unknown. The amount that could be retained by the state if adjudicated amounts were collected also cannot be determined. The total adjudicated amount includes Medicaid, K-TAP, and Food Stamps.

Table 3.4
Attorney General's Special Investigations Division's Welfare Fraud Cases (1999 to 2003)

Calendar Year	Cases Assigned*	Adjudicated Amount**
1999	406	$1,568,248
2000	356	$1,348,861
2001	373	$1,230,840
2002	359	$1,068,501
2003	267	$1,390,758
Total	1,761	$5,500,208

*The caseload numbers in 2002 and 2003 exceed the cap of 210 because the data are for calendar years, and the cap is applicable to fiscal years.
**The exact state share is unclear because the amount includes recoveries from various programs, including Medicaid, K-TAP, and Food Stamps.
Source: Compiled by Program Review staff using data provided by the Office of the Attorney General.

[4] While the contract between the Office of Attorney General and the Cabinet for Health and Family Services specifies a cap of 210, there is an allowable variance of plus or minus 10 percent. Additionally, a case will not be returned because it exceeds the cap if the allegation contains special or unusual circumstances, such as the involvement of a state worker. If there are insufficient funds in the contract to cover program costs for a given fiscal year, general fund moneys of the Office of the Attorney General will be used.

Investigations have included 14 cases involving DCBS caseworkers.

Investigations in 2002 and 2003 included 14 cases involving DCBS caseworkers, with estimated fraud of more than $563,000. The division is investigating more caseworkers for fraudulently obtaining benefits for themselves or others.

Kentucky Attorney General's Investigations of Fraud by Medicaid Providers and Pharmaceutical Companies

In 1977, Congress enacted the Medicare-Medicaid Anti-Fraud and Abuse Amendments, which established the state Medicaid Fraud Control Unit Program (MFCU). The legislation provides states with funding to investigate and prosecute Medicaid provider fraud, as well as the abuse or neglect of patients in all health care facilities that receive Medicaid funds. MFCU's funding is 75 percent federal and 25 percent state. Forty-seven states, including Kentucky, have federally certified MFCUs.

Kentucky's Medicaid Fraud Control Unit (MFCU) is responsible for conducting investigations of Medicaid providers and pharmaceutical companies accused of fraudulent activity.

The Attorney General's Medicaid Fraud and Abuse Control Division is responsible for conducting investigations of Medicaid providers and pharmaceutical companies accused of fraudulent activity. A Medicaid provider is any person or entity that bills the Medicaid program for health care goods and services provided to a Medicaid recipient. Providers include doctors, dentists, hospitals, nursing homes, pharmacies, durable medical equipment vendors, ambulance companies, and providers of nonemergency medical transportation.

Medicaid fraud includes billing for services not rendered, double billing, and billing for unnecessary services.

Provider fraud comes in many forms. Some typical schemes providers use to defraud the Medicaid program are listed below.

- Billing for services not rendered. Example: A Medicaid transportation provider bills for trips not made.
- Double billing. A provider bills Medicaid and a private insurance company for the service, or two providers request payment for the same recipient for the same service on the same day.
- Substituting generic drugs. Example: A pharmacy bills Medicaid for a brand name prescription drug when a low-cost generic was dispensed to the recipient at a lower cost to the pharmacy.
- Billing for unnecessary services. Example: A provider performs numerous tests, which are medically unnecessary and result in an unreasonable and unnecessary expense to Medicaid.

- Upcoding. A provider bills for more expensive procedures than were actually performed. Example: A psychiatrist bills for individual therapy for several people when group therapy was actually provided.

Kentucky's MFCU receives referrals for investigations from multiple sources, including the CHFS Office of Inspector General, police agencies, U.S. attorneys, citizens, and the media.

Kentucky's MFCU receives referrals for investigations from multiple sources, including the CHFS Office of Inspector General, Federal Bureau of Investigation, police agencies, U.S. attorneys, citizens, and the media.

Referrals from the Inspector General generally consist of complaints of third-party liability, recipient ineligibility, and recipient fraud, which are outside MFCU's jurisdiction. Therefore, the Attorney General's Special Investigations Division investigates these complaints.

When MFCU officials determine that a complaint merits investigation, a case is opened, investigated, and may ultimately be tried in court. MFCU prioritizes investigations by the expected impact, including financial gain and deterrence. Convictions of providers and pharmaceutical companies may deter others who would consider fraud. The amount of fraud that is avoided because of publicity surrounding convictions cannot be determined.

Recoveries are obtained through convictions and administrative and global settlements. Global settlements resulted in $5.7 million for the state over the past five years.

MFCU investigations result in recoveries through convictions and administrative and global settlements. Convictions result in a provider being found guilty of a crime in a court of law. On conviction, restitution is ordered, which the provider must pay to the Commonwealth. An administrative settlement occurs when a provider agrees to pay the Commonwealth in order to avoid going to court. In a global settlement, Kentucky is one of many plaintiffs receiving a recovery. Global settlements usually entail several states settling with a provider. Table 3.5 shows the state share of the total amounts recovered by MFCU from January 1, 1999, through April 30, 2004.

Kentucky's MFCU investigations have resulted in an increasing amount of money through global settlements over the past five years, with a total savings to the state of $5.7 million. MFCU officials stated that the increased collections are a result of the various state MFCUs working closely with one another and with the U.S. Department of Justice.

Table 3.5
State Share of Medicaid Fraud and Abuse Control Division's Recoveries
(1999 to April 30, 2004)

Calendar Year	Convictions	Restitution Ordered	Administrative Settlements*	Reimbursement Ordered	Global Settlements**	Result
1999	10	$24,350	4	$74,271	4	$448,798
2000	6	$195,150	1	$15,719	1	$5,525
2001	6	$175,180	1	$450,961	5	$815,783
2002	7	$51,480	3	$196,331	1	$145,496
2003	3	$32,549	2	$120,382	5	$1,622,418
1/1 to 4/30/04	2	0	8	$107,325	2	$2,671,356
Totals	34	$478,710	19	$964,992	18	$5,709,378

*Cases settled out of court.
**Settlements involving several plaintiffs, usually other states.
Source: Compiled by Program Review staff using data provided by the Office of the Attorney General.

Kentucky is expected to receive $10 million from a settlement with two drug manufacturers.

Kentucky's Medicaid program is expected to receive nearly $10 million from a settlement with drug manufacturers GlaxoSmithKline and Bayer Corporation for violating the federal Medicaid drug rebate law. Medicaid received a check for $2,385,000 (all state dollars) as part of the settlement with the Bayer Corporation in January 2004.

The investigation was initiated after a whistleblower complaint was filed against Bayer in February 2000. The investigation expanded to include GlaxoSmithKline and revealed that the companies sold many heavily prescribed medications to several large HMOs at deeply discounted prices. The HMOs then repackaged and sold the drugs. The companies then failed to report these "best price" discounted sales to Medicaid in accordance with their agreement under the drug rebate law. As a result, state Medicaid programs paid millions more than they should have paid for the drugs during a period of three to five years.

In October 2003, the Attorney General filed several lawsuits against pharmaceutical companies alleging fraudulent and deceptive acts in the pricing and marketing of prescription drugs paid for by Medicaid. The Attorney General alleged that the drug companies reported inflated average wholesale prices, causing Medicaid to pay more for the drugs. It is alleged that drug companies marketed the drugs to pharmacies at significantly lower prices and provided incentives to pharmacies to purchase their drugs. It is also alleged that drug companies were providing incentives to doctors to prescribe their drugs, resulting in Medicaid reimbursing pharmacies much more than the price paid for the medications. The cases are pending in Franklin Circuit Court.

Projected Collections Are Included in Agency Budget Requests

The state gains new money only to the extent that projected collections are exceeded or more improper payments are avoided.

The state gains new money only to the extent that projected collections are exceeded or more improper payments are avoided. Projected collection of debt is included in some state agency budget requests. In programs such as Food Stamps and K-TAP, the collections are not expected to be significant. In Medicaid, millions of dollars are carried forward from prior years, and millions more are collected and used to fund operations and services.

Medicaid collections of overpayments and third-party liability are credited to a separate Claims and Recovery Fund. Drug rebate collections are considered a reduction of cost and are not included in this fund.

Some anticipated collections are budgeted to pay Medicaid's administrative expenses and, in some years, to pay benefit costs.

Some anticipated collections of overpayments and third-party liability are budgeted to pay Medicaid's administrative expenses and, in some years, to pay benefit costs. Administrative expenses include the cost of recovery activities, which are generally funded at 50 percent by CMS. The unused balance in the Claims and Recovery Fund is carried forward to the next fiscal year and may be used only for Medicaid costs.

In FY 2001 and FY 2002, the Claims and Recovery Fund had a beginning balance of $18 million carried forward from the previous year. This balance means that collections in prior years exceeded expenditures by $18 million. At the beginning of FY 2004, the balance was down to $14 million. The Office of the State Budget Director projected that the funds will be depleted by the end of FY 2006.

The Claims and Recovery Fund might be depleted because the state avoids making improper payments and has less to collect, and amounts carried forward from previous years are expected to be used in FY 2005 and FY 2006 budgets. Medicaid's success in preventing improper payments saves money in the current year and eliminates the effort of collecting amounts that should not have been paid.

Table 3.6 shows the activities in the Claims and Recovery Fund from FY 2001 through FY 2003 and the projected activity for FY 2004. The FY 2004 projection shows collections of $43.5 million, a 72 percent increase over actual collections in FY 2003. Actual collections through June 24, 2004, were $ 40.5 million.

Table 3.6
Medicaid Claims and Recovery Fund
(in millions of dollars)

	Actual FY 2001	Actual FY 2002	Actual FY 2003	Projected FY 2004
Balance Forward	$18.0	$18.1	$14.7	$13.9
Plus: Current Receipts	25.5	14.5	25.3	43.5
Less: Budget Reduction	0.0	0.0	0.0	[2.5]
Total Available	43.5	32.6	40.0	54.9
Less: Administration	[13.9]	[15.7]	[16.2]	[20.3]
Less: Benefits	[11.5]	[2.4]	[9.9]	[0.0]
Total Expenditures	25.4	17.9	26.1	20.3
Balance Forward (in $ millions)	$18.1	$14.7	$13.9	$34.6

Source: Compiled by Program Review staff using information provided by the Office of the State Budget Director.

Chapter 4

Establishment and Enforcement of Child Support Orders Affect Eligibility and Participation in Public Assistance Programs

Uncollected child support is covered in this report because it is a root cause of state spending that would not otherwise be required.

Uncollected child support is not considered a debt owed to the state, so it does not show up in any accounting of receivables. Uncollected child support is covered in this report, however, because it is a root cause of spending in specific government programs that would not otherwise be required.

Child support payments are considered income when determining an applicant's eligibility for such programs as the Food Stamp Program, K-TAP, Medicaid, and the Kentucky Children's Health Insurance Program (KCHIP). When noncustodial parents do not fulfill their child support obligations, some custodial parents' income is decreased enough to qualify their families for these public assistance programs. More participants in these programs raise state and federal expenditures or decrease the benefits available to others.

When child support orders are not enforced, additional families may qualify for public assistance. State Medicaid costs of $2.4 to $11 million could be saved if noncustodial parents provided health insurance as ordered. Uncollected child support also increases state funding of public schools.

Uncollected child support payments can also include unfulfilled medical support orders. Noncustodial parents who do not provide health insurance as ordered increase the number of dependent children eligible to receive medical care through Medicaid or KCHIP. Program Review staff's analysis indicated that $2.4 to $11.0 million in state Medicaid costs could be saved if noncustodial parents who have access to health insurance and can afford to pay for dependent coverage provided insurance as ordered. An undetermined amount of K-TAP and Food Stamp Program costs could be saved if noncustodial parents made child support payments as ordered.

Uncollected child support also affects public school funding through the Support Educational Excellence in Kentucky (SEEK) formula. School districts receive additional funding through the formula for "at-risk" students, defined as those who receive free lunches through the federally funded school lunch program. Uncollected child support means more students become eligible for free school lunches and are thus classified as at risk. State SEEK expenditures increase by an undetermined amount as a consequence.

This chapter provides background information about the child support program; details how unpaid child support affects eligibility for food stamps, K-TAP, and Medicaid; and concludes with a discussion of how uncollected child support affects SEEK funding.

Recommendations are made to improve collections by (a) re-examining the costs and benefits of providing financial incentives to county child support offices for improving enforcement of child support orders, (b) examining the consequences of allowing custodial parents who receive K-TAP to keep some or all of their child support payments, and (c) determining whether noncustodial parents who cannot provide dependent health insurance should be required to provide some financial assistance for dependent medical care.

Administration of Child Support

Child support is financial support paid by a parent for a child or children who live in a separate household.

As generally understood, child support is financial support paid by a parent for a child or children who live in a separate household. Child support can be paid voluntarily, or a court or administrative agency may order noncustodial parents to make specified payments. Federal legislation enacted in 1975 mandates that each state operate a government-administered child support program.

The Division of Child Support, located in the Department for Community Based Services in the Cabinet for Health and Family Services, administers Kentucky's child support enforcement program. The cabinet relies on contracting officials, usually county attorneys, to provide local services. Such services include establishing paternity, securing child support and medical support orders, and enforcing and collecting support obligations. Child support payments are made to and disbursed from a statewide central collection unit.

Any parent who resides in Kentucky can use state child support services. People receiving K-TAP, foster care, or Medicaid must participate in state child support services.

Any parent who resides in Kentucky can use state child support services. People receiving K-TAP, foster care, or Medicaid are required to participate. Others have the option of using a private attorney or other service to establish child support payments. Kentucky's Division of Child Support does not charge an application or other fee. Every custodial parent has access to a free child support service.

Child Support Cases Are Increasing

In recent years, the number of open child support cases increased by 10 percent, to more than 310,000 cases. Most of the growth has come from families who have never received public assistance.

From FY 1999 to FY 2003, the number of open child support cases increased by approximately 10 percent, to more than 310,000 cases. However, the number of children in child support declined by approximately 25,000 over this period.

The growth in caseload has come from families who have never received public assistance.[1] Between fiscal years 2001 and 2003, the number of child support cases for families who have never received public assistance increased by 20.5 percent. In contrast, the number of child support cases in which the family had received public assistance dropped by 3.7 percent. This caseload mix would seem to indicate that although uncollected child support leads to higher spending for state public assistance programs, the problem is not getting worse.

Funding

The federal government provides most of the funding for Kentucky's child support program.

The federal government provides most of the funding for operating the child support program. States are reimbursed by the federal government for 66 percent of child enforcement program costs and for 90 percent of genetic testing costs used to establish paternity. States also compete for federal performance incentives based on establishing paternity, establishing support orders, collecting current and past-due payments, and cost effectiveness. In FY 2002, Kentucky received $8.1 million in federal incentives.

Kentucky also relies on restricted and general funds to operate the child support program. Restricted funds include Temporary Assistance to Needy Families repayments and interest income. In FY 2004, 65 percent of funding came from the federal government, 20 percent from restricted funds, and 15 percent from the state's general fund.

Contracting Officials

CHFS contracts with local officials to operate and oversee child support offices.

Generally, the contracting officials who operate and oversee the local child support offices are local county attorneys. CHFS sets performance goals to ensure that contracting officials maintain certain standards. The cabinet bases its evaluations on four of the five criteria used by the federal government to award incentives to the states. CHFS monitors the 20 counties with the worst performance records. Contracts with poorly performing contracting

[1] The U.S. Department of Health and Human Services defines "public assistance" as Temporary Assistance to Needy Families or foster care.

officials may be terminated. According to cabinet officials, four contracts have been terminated since 1999. (See Appendix D for a list of counties and their performance measures for FY 2004.)

Kentucky reimburses local contracting officials for program expenses at an hourly rate.

Kentucky reimburses local contracting officials for program expenses at an hourly rate up to a predetermined total. Child support enforcement expenses are reimbursed at 100 percent but are capped. The contract caps ensure that the state will not incur limitless expenses.

In 2003, the cabinet and the Kentucky County Attorneys' Association developed an equity plan for contracting officials. The equity plan considered reimbursement on the basis of average cost per case. Before 2003, some contracting officials were apparently receiving significantly higher payments than others.

In the past, contracting officials received federal incentive payments via the state.

Contracting officials once received federal incentive payments via the state for meeting or exceeding certain child support enforcement expectations. These incentive payments ended in the early 1990s after a northern Kentucky county attorney kept accumulated child support incentive money after leaving office. Local officials wanted the funds to be declared property of the county. A judge ruled in favor of the county attorney, allowing him to keep the child support incentive payments. The state ended incentive payments to local contracting officials after this incident. No other significant incentive payments are available to contracting officials for meeting or exceeding child support enforcement expectations.

Without financial incentives, contracting officials are unlikely to expend county funds for child support enforcement activities.

Without financial incentives, contracting officials are unlikely to expend county funds above and beyond their current expenses for child support enforcement activities, including medical support enforcement. Contracting officials and the counties that they represent have no financial incentive to improve child support enforcement. Almost all benefits accrue to the state and federal governments through decreased eligibility and lower costs for various public assistance programs.

Kentucky does have a reason to promote more aggressive child support enforcement efforts at the local level. As noted, eligibility for K-TAP, the Food Stamp Program, Medicaid, and public school funding are at least partially dependent upon how many child support orders are enforced. Without financial incentives for local contracting officials, child support enforcement efforts are unlikely to improve significantly.

Recommendation 4.1

The Cabinet for Health and Family Services should reexamine the costs and benefits of providing greater financial incentives to county child support offices for the specific purpose of improving enforcement of child support orders. One option is to use available cash. The child support restricted fund ended fiscal year 2003 with almost $2 million in cash. The cabinet may also consider seeking additional funds through the state's budget. Improving enforcement will help the state avoid costs to various public assistance programs and may increase the amount of federal reimbursement and incentive funds available to child support. The cabinet should report to the Program Review and Investigations Committee prior to the 2005 session of the General Assembly on its findings.

Child Support and Food Stamps

The federal Food Stamp Program provides vouchers to allow qualifying low-income individuals and families to purchase food. States are responsible for half of the administrative costs.

The federal Food Stamp Program provides vouchers to allow qualifying low-income individuals and families to purchase food. The federal government pays for program benefits. Uncollected child support increases the number of program participants and directly raises federal benefit expenditures. State administrative costs, which are split 50-50 with the federal government, are likely to rise by an undetermined amount. It is unknown how many food stamp recipients' eligibility would change if noncustodial parents made child support payments as ordered.

Child support payments may be included in a food stamp applicant's gross income. If such payments are not made, more people will qualify for food stamps. An increase in the number of food stamp recipients is likely to increase state administrative costs.

Persons with incomes below a specified resource and income threshold are eligible for food stamps. Child support payments may be included in determining an applicant's gross income.[2] Consequently, whenever a noncustodial parent fails to pay child support, the custodial parent's gross income falls. In some cases, the family becomes eligible for food stamps.

For illustration, consider the hypothetical case of Jane, a custodial mother of two who has monthly earnings of $1,500. She also receives $200 each month in child support payments from the noncustodial parent. Jane's gross monthly income, therefore, equals $1,700, which is $1,500 plus $200.

[2] According to 921 KAR 3:020, child support payments are not considered income if received by a K-TAP or Kinship Care recipient but are required to be transferred to the Division of Child Support to maintain eligibility. Child support payments are considered income if they go directly to the food stamps applicant, according to 921 KAR 3:020.

Under eligibility rules for the Food Stamp Program, a three-person household must have gross income of $1,654 or less to be eligible for assistance. Jane's $1,700 gross income exceeds that level, so she and her children would be ineligible for food stamps. However, if the noncustodial parent fails to pay $200 in child support, Jane's monthly gross income falls to $1,500, which is less than the $1,700 limit, thus qualifying her family for food stamps. This example illustrates how child support payments can change a family's eligibility. Similar examples could be applied to K-TAP, Medicaid, KCHIP, and the free school lunch program.

Child Support and the Kentucky Transitional Assistance Program

K-TAP is the state's public assistance program for low-income families with dependent children or pregnant women.

K-TAP is the state's public assistance program for low-income families with dependent children or pregnant women. Kentucky's program receives funding through the federal Temporary Assistance to Needy Families program. The 1996 federal law creating that program emphasizes that benefits should be temporary and that clients should be encouraged to take responsibility for themselves.

Federal law requires that K-TAP recipients cooperate with the child support agency in establishing paternity and obtaining child support.

Consistent with the goal of personal responsibility, federal law requires K-TAP recipients to cooperate with the child support agency in establishing paternity and obtaining child support. K-TAP recipients must assign their child support rights to the state before receiving benefits. This means that in exchange for K-TAP payments and services, child support payments go to K-TAP instead of the custodial parent.

If the child support payment exceeds the K-TAP payment and no reimbursement is due, the custodial parent receives the K-TAP payment plus the difference between the child support payment and the K-TAP payment.[3] For example, a custodial parent may qualify for a $200 monthly K-TAP payment. The noncustodial parent makes a $250 monthly child support payment. The state will deduct the amount of the K-TAP payment ($200) from the child support amount. This means that the custodial parent will receive $250 per month: the original $200 K-TAP payment *plus* $50 ($250 less $200) in child support.

[3] If the noncustodial parent has arrearages or if past K-TAP payments have not been reimbursed, additional child support payments may not go to the custodial parent.

Because K-TAP benefits are limited to 60 months over a lifetime, CHFS officials indicated that caseworkers encourage custodial parents to withdraw from K-TAP when their child support payments exceed K-TAP payments. Doing so allows custodial parents to retain months of eligibility for the program.

If a K-TAP recipient does not cooperate on child support matters, the state must reduce or eliminate the family's assistance.

If a K-TAP recipient does not cooperate on child support matters, the state Temporary Assistance to Needy Families (TANF) agency must reduce the family's assistance by 25 percent or deny the family TANF assistance. Uncooperative behavior can be difficult to determine, however.

Anecdotal evidence from the cabinet suggests that some custodial parents will provide misleading information to maintain the appearance of cooperation. One example involved a custodial mother who gave the names of multiple men for purposes of establishing paternity. None proved to be the actual father. Because the mother willingly provided information, it appeared that she was being cooperative.

Uncollected Child Support for Children Receiving Public Assistance Totals $159 Million

At most, $159 million in child support arrearages should have been paid to K-TAP. The actual amount of potential K-TAP savings cannot be determined.

As of 2002, child support payments owed but uncollected for children whose families receive public assistance totaled approximately $159 million. This represents the maximum dollar amount that could be used to offset state public assistance payments to custodial parents. The actual amount is likely to be much less. First, some portion of the $159 million is likely uncollectible. Noncustodial parents may be unemployed, deceased, incarcerated, or otherwise unable to provide financial support. Second, a portion of the uncollected amount may represent child support payments that exceeded the K-TAP payment amount and thus should have been passed through to the custodial parent in the first place.

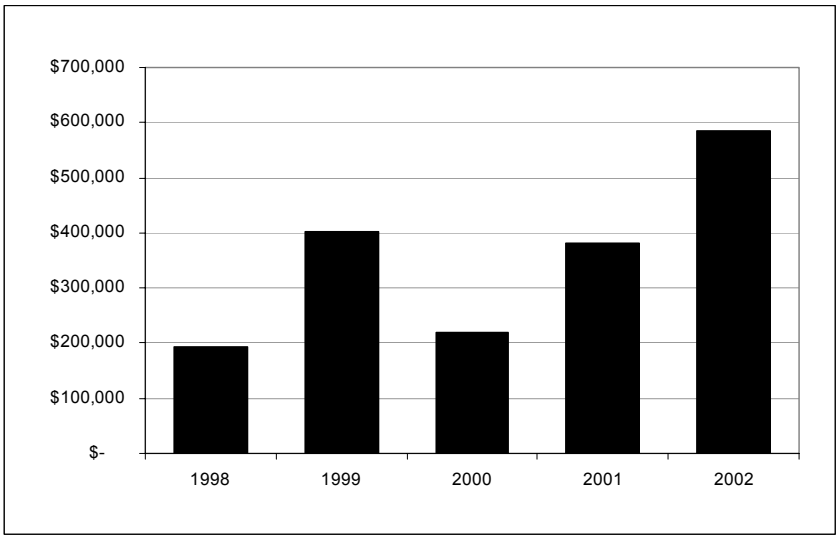
Retaining Child Support Payments

States can recoup TANF or foster care payments to custodial parents by retaining child support payments. Retained child support payments are split between the federal and state government in the same proportion as Medicaid funding: 70 percent federal money and 30 percent state money in Kentucky. Generally, the state keeps the money and reduces a future withdrawal of federal funds by the amount of the federal share. The retained federal funding is available for future program use.

Child support payments to K-TAP families have been minimal.

Child support payments to K-TAP families have been minimal. As indicated in Figure 4.A, from FY 1998 to FY 2002, the highest annual payment amount was less than $600,000. The data seem to indicate that (a) relatively few custodial parents remain on K-TAP when their child support payments exceed the K-TAP payments, and (b) the amount of additional income to custodial parents from staying on K-TAP while receiving child support is relatively small.

Figure 4.A
Child Support Payments to K-TAP and Foster Care Families in Kentucky (FY 1998 to FY 2002)



FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using information obtained from the U.S. Department of Health and Human Services.

Financial Incentives for Cooperating With K-TAP Are Weak

Child support payments—up to the K-TAP cash benefit amount—go to K-TAP, not the custodial parent.

Child support payments—up to the K-TAP cash benefit amount—go to K-TAP, not the custodial parent. Consequently, a custodial mother who receives K-TAP assistance may not receive any child support income if paternity is established. Such a situation can create a financial disincentive for the mother to establish paternity.

If a mother has custody of the children, receives K-TAP benefits, and also receives child support payments directly from the father, perhaps under an informal agreement between the parents, then the mother would be worse off if paternity were established. The cash child support payments would then go to the state. The mother

would still receive K-TAP benefits but would lose the child support payment.

The benefits of increased cash income for the custodial parent often outweigh the risks of reduced K-TAP payments.

Certain child support policies attempt to restrict under-the-table situations whereby the noncustodial parent provides child support without informing the state. For instance, custodial parents are legally obligated to report all income, including income received from the noncustodial parents. K-TAP participants who refuse to help establish paternity face the possibility that their K-TAP payments could be reduced or eliminated. However, as long as the benefits of higher income outweigh these risks, some people are likely to engage in such covert behavior.

Twenty states allow custodial parents to keep a portion of their child support payments. Kentucky does not.

To combat these situations, 20 states allow custodial parents who receive TANF to keep a portion or all of their child support payments (Roberts and Jordan). Doing so may increase cooperation, which could raise child support collections and thus limit the number of families receiving public assistance. Most of the 20 states allow custodial parents to retain up to $50 per month in child support payments. Three states—Connecticut, Minnesota, and Wisconsin—allow custodial parents to retain all child support payments in addition to their TANF support.

Recommendation 4.2

The Cabinet for Health and Family Services should examine the consequences of allowing custodial parents who receive K-TAP to keep some or all of their child support payments. The cabinet should estimate the fiscal impact to the K-TAP program as well as any change in the amount and number of child support obligations being fulfilled. The cabinet should report its findings to the Program Review and Investigations Committee before the 2005 session of the General Assembly.

Medical Support Orders and Medicaid

A noncustodial parent must provide health insurance if it is available through the employer at a "reasonable" cost.

A noncustodial parent must provide medical support to dependent children if health insurance is available through an employer at a "reasonable" cost. Reasonable is defined on the basis of availability. That is, health insurance is considered reasonable if the noncustodial parent's employer offers dependent health insurance coverage.

In Kentucky, the noncustodial parent provides either full dependent health insurance or no direct medical support is ordered.

In Kentucky, medical support orders typically apply to the provision of dependents' health insurance. Payments are not included for dependents' medical bills, a custodial parent's private health insurance for dependent children, or a share of Medicaid expenses if Medicaid covers the dependent children. Medical support orders in Kentucky, therefore, are usually an all-or-nothing proposition—either full dependent health insurance is provided and paid for by the noncustodial parent or no direct medical support is ordered.

States are required to notify employers of medical support orders. Employers are required to enroll children in their health insurance plan.

States are required by the federal government to use the State Directory of New Hires to learn about the employment of noncustodial parents. Employers must be notified by the state about an existing medical support order and enroll a noncustodial parent's children in a health insurance plan if one is provided. It is unclear how many employers receive these notices and how many employers then enroll the noncustodial parent's dependent children in a health insurance plan.

The Division of Child Support is working with the Department for Medicaid Services on pilot projects in Franklin and Christian Counties to induce noncustodial parents whose dependent children are eligible for Medicaid to provide health insurance as ordered.

Most Medical Support Orders Are Not Fulfilled

More than 94 percent of the orders to provide health insurance in Kentucky went unfulfilled in FY 2002.

Health insurance was ordered in 79,823 of the 86,789 medical support orders in Kentucky in FY 2002. Health insurance was provided in fewer than 4,400, or 5.5 percent, of the cases. In other words, more than 94 percent of the orders to provide health insurance went unfulfilled. Nationally, about 82 percent of all health insurance orders went unfulfilled.[4] Figure 4.B compares Kentucky to the national averages regarding percentages of child support cases with health insurance orders and cases in which insurance orders were met.

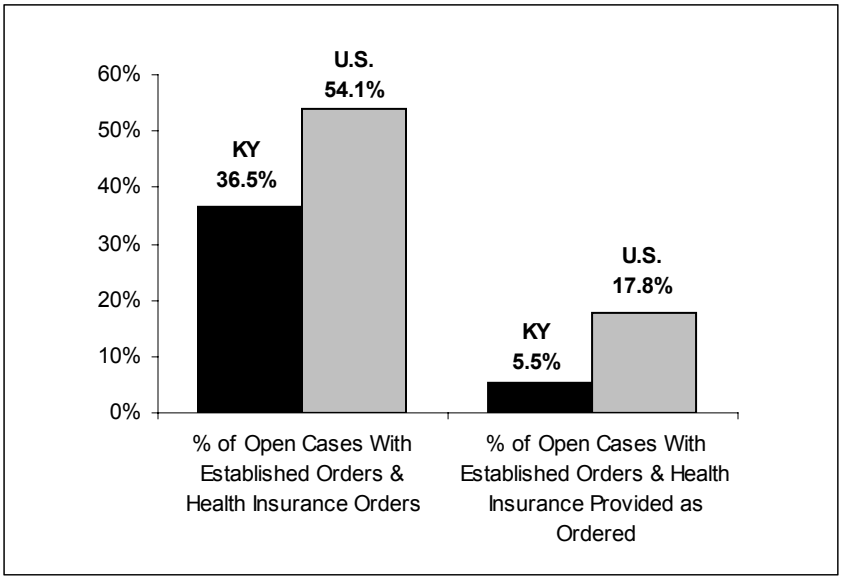
From FY 2001 to FY 2003, the number of medical support orders issued in Kentucky increased 29 percent to 96,500. The share of all open child support cases with established orders increased from 36.5 to 42.5 percent over this brief period.

Similar to unpaid child support payments, some medical support orders may go unfulfilled for reasons other than the noncustodial

[4] FY 2002 is the most recent year for which both federal and state data are available. In FY 2003, health insurance was ordered in 88,196 of Kentucky's 96,510 medical support orders and was provided in 5.7 percent of cases.

parent avoiding payment. Incarceration, unemployment, or lack of access to health insurance may be contributing factors.

Figure 4.B
Health Insurance Orders in Kentucky and the U.S.
(FY 2002)



FY is federal fiscal year, October 1 through September 30.
Source: Compiled by Program Review staff using information obtained from the U.S. Department of Health and Human Services.

As most medical support orders in Kentucky are for the provision of health insurance, total payments by noncustodial parents to the custodial parent for medical expenses other than insurance are relatively small. In FY 2002, $3.2 million in such payments were made, primarily for prenatal and birthing expenses, according to CHFS officials.[5] On average, payments of $384 were made for each medical support order that did not order health insurance.

Incentives for Avoiding Medical Support Orders

Dependent children who are eligible for Medicaid or KCHIP can have medical coverage even if the noncustodial parent does not provide medical support.

Dependent children who are eligible for Medicaid or KCHIP can have medical coverage regardless of whether their noncustodial parent provides medical support. Consequently, the noncustodial parent, the custodial parent, and the dependent children may fare better if the noncustodial parent does *not* provide medical support.

[5] This represents an increase. In FY 1998, medical support payments totaled $235,000.

By not providing medical support and letting dependent children be covered by Medicaid, a noncustodial parent may be able to

- decrease the total child support obligation,
- increase the amount of available cash resources to the custodial parent, or
- obtain a benefit from some combination of the two.

Custodial parents may be just as satisfied if health care coverage for dependent children is funded by noncustodial parents or by Medicaid. They may be more satisfied if Medicaid covers their dependent children and noncustodial parents provide additional child support payments in lieu of health insurance. Both the custodial parent and dependent children could be better off financially. These benefits may outweigh the risks of being penalized for not notifying child support officials that a noncustodial parent failed to provide health insurance or that the noncustodial parent was making informal child support payments.

Unfulfilled Medical Support Orders Increase State Costs

When a noncustodial parent fails to comply with a medical support order, the children may become eligible for Medicaid or KCHIP.

When a noncustodial parent fails to comply with a medical support order, dependent children who would not qualify if medical support were provided may become eligible for Medicaid or KCHIP. Because Medicaid costs are divided between the federal government and the states, Kentucky's expenses would increase by less than $1 for each additional Medicaid dollar spent.[6] Had the noncustodial parent provided dependent health insurance, Kentucky would not face these increased Medicaid costs.

Most studies have concluded that some noncustodial parents who do not provide dependent health insurance as ordered have access to health insurance.

Several recent studies have examined the issue of Medicaid cost savings due to the fulfillment of child support orders.[7] Their research methods and approaches differed, but the authors reached similar conclusions. They generally determined that (a) some noncustodial parents have access to reasonable-cost health insurance coverage for their dependent children, (b) some noncustodial parents can pay some dependent children medical bills even if they cannot provide health insurance, and (c) the overall state financial benefit from these noncustodial parents providing medical support is significantly less than the amount that could be collected if every medical support order was fulfilled.

---

[6] The exact division can vary by year. The federal matching rate in FY 2004 was 70.09 for Medicaid and 79.06 for KCHIP.

[7] Barnow et al; Garasky, Keng, and Jensen; Kaplan and Rothe; Laudan; Roberts; Wheaton, 2004; Wheaton, 2000; Wheaton and Sorenson; U.S. Office of Inspector General, Health and Human Services.

The Commonwealth could have saved $2.4 to $11.0 million in state funding in FY 2003 if noncustodial parents with access to health insurance had provided it.

Based upon this and other information described in Appendix E, Kentucky's Medicaid program could have realized state savings of between $2.4 and $11.0 million in FY 2003 had noncustodial parents with access to reasonable dependent health insurance provided medical support as ordered. Total Medicaid savings, which include the federal share, would have totaled between $8.1 and $36.5 million for FY 2003.

Unfulfilled medical support orders also mean the dependent children may become or remain uninsured.

Unfulfilled medical support orders also mean that the dependent children may become or remain uninsured. Uninsured dependent children do not necessarily result in costs to the state. However, Medicaid costs could be incurred if these dependent children use emergency services paid for by Medicaid.

Recommendation 4.3

The Cabinet for Health and Family Services should determine whether noncustodial parents who cannot provide dependent health insurance should be required to provide some financial assistance for dependent medical care. Medical support can include partial or full payment of dependent children's medical bills, partial or full payment of private health insurance coverage accessed by the custodial parent for their dependent children, or reimbursement to Medicaid for the use of Medicaid services.

A concern about requiring noncustodial parents to provide a cash payment for medical support is that it may come at the expense of child support payments. If medical support orders create a financial obligation that is too large for some noncustodial parents, it may limit their ability to make full child support payments.

Unfulfilled Child Support Payments Affect SEEK Funding

School districts receive additional state funding for each student who is classified as at-risk, defined as qualifying for free lunches.

Under the SEEK formula for financing the state's K-12 education system, school districts receive additional funding for each "at-risk" student. At risk is defined as a student who qualifies for free lunches through the federal program.[8] Noncustodial parents who fail to make child support payments decrease the amount of income available to a custodial parent. Because eligibility for free lunch is based on income, the likelihood that a custodial parent's

[8] 702 KAR 3:270.1 requires per pupil payment equal to 15 percent of base funding. In FY 2004, base funding was $3,191, so at-risk per pupil funding was $478.

children will become eligible increases.[9] As the number of children who receive free lunches increases, so does the amount of state funding that school districts receive. The impact would occur in direct funding for at-risk students and supplemental funding.

If more child support were collected, fewer students would be at risk.

This is not just a matter of definition. The reason at-risk status has been based on receiving free lunch is that low family income has been shown to have a detrimental effect on dependent students' chances for academic success. If a family's financial resources are improved through increased child support, then the student's environment is likely to improve as well.

In FY 2004, the state provided school districts an extra $478 for each at-risk student.

In FY 2004, the state provided school districts an extra $478 for each at-risk student. For FY 2004, it is estimated that 267,000 students participated in the free school lunch program and thus were classified as at risk. Based on this information, for every 1 percent increase in the number of children participating in the free school lunch program, state expenditures increase by $1.3 million.

School districts also receive supplemental state funding for increasing their amount of local effort, which is commonly referred to as Tier I.[10] Tier I funding is based partly on the amount of funding for at-risk students. An increase in the number of students receiving free school lunch, therefore, generally increases the amount of state supplemental funding to schools. For FY 2004, it is estimated that every 1 percent increase in the number of students participating in the free school lunch program raises total state Tier I expenditures by about $76,000.

It does not appear possible, however, to accurately calculate the number of students who are made eligible for free school lunches because their noncustodial parents failed to make child support payments. Such a calculation would require matching children for whom child support is owed with free lunch applications. To staff's knowledge, no such data exist.

The state could save more than $6 million a year if child support collections were increased to reduce the number of at-risk children by 5 percent.

Although an exact number is not available, it is possible to extrapolate the potential financial impact to the state from different

[9] It is also the case that the noncustodial parent's gross income will be affected by payment or lack of payment of child support, particularly for determination of such benefit programs as free and reduced-price school lunches and K-TAP.

[10] For more detailed information about the SEEK formula, and Tier I funding in particular, see Legislative Research Commission Report No. 310: *The SEEK Formula for Funding Kentucky's School Districts: An Evaluation of Data, Procedures, and Budgeting*.

hypothetical changes in the at-risk population. Table 4.1 shows the potential decreases in state expenditures by various percentage reductions in the number of students participating in the free school lunch program. The precise impact that unpaid child support has on state SEEK funding cannot be determined. However, if child support collections were increased enough to reduce the number of at-risk students by 5 percent, the state would save approximately $6.8 million per year. Ten and 20 percent reductions would decrease annual state SEEK obligations by $13.6 and $27.1 million, respectively. These savings could translate into lower state expenditures, a redistribution of SEEK funds, or some combination of these options.

Table 4.1
Change in SEEK Expenditures by Various Hypothetical Changes in the Number of At-risk Students

State Expenditure Category	Percentage Change in Number of At-risk Students			
	1%	5%	10%	20%
At-risk	$1,300,000	$6,400,000	$12,800,000	$25,600,000
Tier I	$76,000	$381,000	$763,000	$1,525,000
Total	$1,376,000	$6,781,000	$13,563,000	$27,125,000

Chapter 5

The Finance and Administration Cabinet Can Lead the Efforts To Prevent Improper Payments and Collect Debts

Two state laws were enacted in 2004 to improve the prevention of improper payments and collection of debts.

In its 2004 regular session, the General Assembly enacted two laws to improve existing requirements for preventing improper payments and collecting debts: Senate Bill (SB) 228 and House Bill (HB) 162. SB 228 provides new requirements for preventing improper payments. Both HB 162 and SB 228 provide new requirements for collecting debts. The Finance and Administration Cabinet is working with state agencies and the Court of Justice to implement the new laws.

This chapter provides an overview of the new laws, similar federal requirements, and other states' best practices.

This chapter provides an overview of the requirements of HB 162 and SB 228. It also describes federal agency requirements that are similar to but wider in scope than HB 162 and SB 228 that state officials can consider when implementing the new state laws. Best practices of other states are summarized. Finally, this chapter provides recommendations to (a) establish a statewide work group on risk assessment to consider the risk of improper or unnecessary payments and the risk of not collecting debt, (b) specify actions that should be taken by state agencies, (c) specify actions that should be taken by the court system, (d) specify guidance that should be issued to agencies to prevent improper payments and collect debts, (e) establish reporting requirements for improper payments, (f) provide assistance in implementing plans to reduce improper payments and to collect debts, (g) explore the use of all available collection methods, (h) include best practices of other states in designing the central collection system, and (i) develop a statewide policy for deposits.

Recommendations are made to help implement laws and best practices efficiently and effectively.

HB 162 and SB 228 should help ensure that taxpayers are not unfairly penalized because of some individuals' and companies' fraudulent activities and/or failure to pay obligations. The Finance and Administration Cabinet, state agencies, and the court system are planning ways to satisfy their new responsibilities. Much work remains to be done. The recommendations in this chapter are made in the spirit of cooperation to help implement HB 162, SB 228, and best practices efficiently and effectively. They are not intended to imply criticism of current or planned actions.

Implementing the recommendations could take years. Additional staff and other resources may be necessary to coordinate a statewide approach to prevent improper payments and collect debts. However, the potential benefit to the Commonwealth's economic condition should justify the effort.

Identifying and Preventing Improper Payments

Finance is required to develop a system of internal controls and preaudit policies and procedures to detect errors, fraud, and abuse before a check or warrant is issued.

SB 228 requires the Finance and Administration Cabinet (Finance) to develop for state agencies a system of internal controls and preaudit policies and procedures to prevent and detect errors, fraud, and abuse before a check or warrant is issued. SB 228 recognizes the diversity of programs and activities carried out by state agencies by requiring Finance to develop internal controls and preaudit procedures that meet the unique needs of each agency. SB 228 requires Finance to

- consult with each agency to ascertain unique fraud risks;
- establish policies and procedures for agency-level oversight of fraud risks, including risk assessment, risk tolerance, management policies, and fraud-prevention processing controls; and
- establish systems and procedures for detecting errors and fraud and preventing payment of erroneous or fraudulent vendor invoices submitted for payment, applications submitted for benefits, claims for refunds, and other disbursements.

Specialized knowledge and expertise in fraud detection and prevention may be needed.

SB 228 also recognizes that specialized knowledge and expertise may be needed. Finance is required to consult with the Auditor of Public Accounts, the Commonwealth Office of Technology, the American Institute of Certified Public Accountants, the Association of Certified Fraud Examiners, law enforcement agencies, or any other entity with knowledge and expertise in detecting and preventing fraud.

Finance has already taken steps to strengthen internal controls over procurement card use, cell phone use, travel reimbursement, and other administrative expenses. When SB 228 is fully implemented, steps will be taken to prevent improper payments in all programs and activities and to identify improper payments when they occur. When improper payments are identified, they become debts owed to the state. Chapter 3 of this report described the steps being taken by Medicaid to prevent improper payments and to collect them when they occur. SB 228 extends similar requirements to all state programs and activities.

Collecting Debts

State agencies and the courts are required to refer uncollected debts to Finance for collection. The cabinet may choose to attempt collection or may return the debt to the agency or court for collection or write off.

Both HB 162 and SB 228 require state agencies and the court system to refer uncollected debts to Finance for collection. A survey of state controllers indicated that 17 states already had a central collection unit as of 1999 (National Association).

Finance has the option of attempting to collect state agency and court debt or returning the debt to the agency or court for collection or write off. Some debts are attributable to improper payments, such as overpayments to Medicaid providers and food stamp recipients. Some amounts, such as unenforced child support orders, are not debts owed to the state but must be collected to ensure the state's fiscal integrity, as described in Chapter 4 of this report.

Finance may charge interest and a 25 percent collection fee on uncollected debts.

HB 162 and SB 228 permit Finance to impose interest and a 25 percent collection fee on uncollected debts. Finance may retain the collection fee or may choose to retain its actual collection costs if costs are less than the fee. In this way, the effort of collecting debt is paid for by the collections. The state controllers' survey indicated that 21 states add the cost of collections to the debt (National Association).

Finance will issue administrative regulations for agencies without statutory procedures for debt collection.

For agencies without statutory procedures for collecting debts, Finance is now required to issue administrative regulations. The regulations will provide standards and procedures covering collection of debts, notices to persons owing debts, information to be monitored concerning the debts, an appeals process, and writing debts off the books.

Current and potential collection mechanisms include tax refund intercept; unemployment compensation intercept; vendor offset; liens on debtor assets; and acceptance of payments by cash, check, credit card, and wire transfer. The advantage of getting money in the state's bank account as soon as possible is described in Appendix F.

Annual debt collection reports are required to be submitted to the General Assembly.

By October 1, 2004, Finance is required to report to the General Assembly the amount, type, and age of debts referred by state agencies for collection; the amounts collected; and the amounts deemed not cost-effective to collect. The report must include information on debts resulting from improper payments. By October 1, 2005, the Court of Justice is required to submit similar reports by county to the General Assembly. However, this report is required to include only debts of the previous fiscal year. The

courts do not have a method of accumulating information on unpaid debts from prior years.

Finance has started identifying and collecting debts.

Finance has begun working with state and local agencies to identify and collect debts. Steps taken include devoting more resources to collecting taxes owed the state, working with local governments to collect property taxes, and collecting overdue child support payments.

Finance is developing an electronic system for agencies and the courts to refer debts for collection.

Finance is developing an electronic system for agencies and the courts to refer debts for collection through the statewide Management Administrative and Reporting System. This system will provide standardized policies and procedures and will eliminate the need for Finance staff to manually input debt information, which will reduce the potential for errors and fraud and save valuable staff time.

Eleven states included debt-collection capability in the state's accounting system as early as 1999.

The state controllers' survey indicated that 11 states included debt collection capability in the states' accounting systems as early as 1999. The survey also showed that 26 states, including Kentucky, had a central debt offset program; and 22 of those states use the debtor's Social Security number or federal identification number as a common identifier. The survey further showed that 28 states notify debtors before any offset of payments is made; of those, 26 states notify debtors that future payments from the state may be used to satisfy the debt. Kentucky is included in both the latter categories (National Association).

Kentucky can use best practices of other states and the federal government as guidance.

The rest of this chapter describes best practices of other states and the federal government for preventing improper payments and collecting debts. Finance could incorporate the experience of other states and the federal government when designing the systems, policies, and procedures to prevent improper payments and collect debts.

The Federal Government's Approach

The federal government responded to the need for a government-wide approach to collecting debt with the federal Debt Collection Improvement Act of 1996. The debt collection requirements of HB 162 and SB 228 are very similar to the act, so no additional description of that federal act is included in this chapter.

The federal government also recognized the need for a government-wide approach to preventing improper payments.

Improper payments include inadvertent errors, such as duplicate payments and calculation errors; payments for unsupported or inadequately supported claims; payments for services not rendered or rendered to ineligible beneficiaries; and payments resulting from fraud and abuse. The U.S. Government Accountability Office (formerly General Accounting Office) stated that the U.S. Office of Management and Budget estimated that improper payments in public benefit programs exceed $35 billion a year (United States, "General").

The Improper Payments Information Act of 2002 requires most large federal agencies to review annually all programs and activities they administer and identify those susceptible to significant improper payments. Significant improper payments are defined as those that exceed both 2.5 percent of program payments and $10 million. Once agencies identify their susceptible programs, the act requires them to estimate and report to Congress the annual amount of improper payments. The report must include discussion of the causes of the improper payments identified, actions taken to correct those causes, and results of the actions taken.

The federal Office of Management and Budget works with federal agencies to implement the Improper Payments Act.

The U.S. Office of Management and Budget (OMB) is responsible for working with federal agencies to implement the Improper Payments Act. OMB works with agency officials and a joint work group of members of two councils. The President's Council on Integrity and Efficiency consists of the presidentially appointed inspectors general, whose mission is to coordinate and enhance efforts to promote integrity and efficiency and to detect and prevent fraud, waste, and abuse in federal programs. The Chief Financial Officers Council is an organization of the chief financial officers of the largest federal agencies, senior officials of OMB, and the U.S. Treasury who work collaboratively to improve financial management in the federal government.

A Statewide Approach Is Recommended

Resources should devoted to where the most benefit can be obtained for the state. The emphasis should be on saving state money, collecting state money, and making the fullest use of federal money.

Requirements such as those of the federal Improper Payments Act, combined with the provisions of HB 162 and SB 228, could form the foundation for an approach that could help the Commonwealth focus on the most efficient and effective ways to save and collect state dollars.

Kentucky's Finance and Administration Cabinet and the Office of the State Budget Director have responsibilities equivalent to those

of OMB. Kentucky could adopt a similar mechanism to the OMB joint work group to discuss and develop best practices and other methods to meet the requirements of HB 162 and SB 228 to prevent improper payments and to collect state debts. The emphasis should be on saving state money, collecting state money, and making the fullest use of federal money. In many programs, the federal government will pay a significant portion of the cost of preventing improper payments and collecting debts, often ranging from 50 to 75 percent.

Budget constraints and personnel caps hinder agencies' efforts to prevent improper payments and collect debts.

In practice, constraints on appropriations and the number of personnel may cause state officials to do less than is desired to prevent improper payments and collect debts. A risk assessment at a statewide level, similar to that at the federal level, could focus scarce resources on programs and activities most at risk of making improper payments from state funds and not collecting state debts. Significant improper payments for the state should be quantified in a manner similar to that used by the federal government.

A statewide risk assessment could focus resources where they are most needed and show how some agencies' actions affect other agencies. Such an assessment can lead to a statewide risk-management policy.

A statewide risk assessment also could reveal how action or inaction by one state agency can affect other agencies' risks. Chapter 4 of this report showed how unenforced child support orders increase the costs of Medicaid and other programs. State payments made on behalf of these children are not technically considered improper payments but are unnecessary payments that should be avoided.

The statewide risk assessment can be an important step in implementing a statewide risk-management policy. All major risks must be identified and their impact must be assessed before they can be managed for maximum benefit to the state.

Recommendation 5.1

The Finance and Administration Cabinet should establish a formal work group on risk assessment to address improper payments of state money and collection of state debts. The work group should include Finance officials, the State Budget Director, and agency chief financial officers and inspectors general. The work group should consider each agency's unique risks and the relationships among programs in which action or inaction by one agency can affect other agencies' risks. Agencies and programs identified as being most at risk of making improper payments from state funds or not collecting state debts should be identified and targeted for improvement.

Specific Actions Should Be Taken by State Entities

Federal agencies identified by the joint work group as being most at risk of making improper payments are required to take specific actions:

- Assign responsibility to a senior official, such as the chief operating officer or the chief financial officer, for establishing policies and procedures for assessing agency and program risks of making improper payments; taking actions to reduce improper payments; and reporting the results of the actions to agency management for oversight and other actions as deemed appropriate;
- Develop detailed action plans to determine the nature and extent of improper payments for all agency programs and/or activities;
- Identify cost-effective control activities to address risk areas; and
- Periodically report to the agency head and the U.S. Congress on the progress made in achieving improper payment reduction targets and future action plans for controlling improper payments.

State entities that are at risk of making improper payments and/or not collecting debts should be required to take specific actions. State actions should emphasize saving and collecting state money and using federal funds to collect money for the state.

Similar requirements could be established for Kentucky's state entities and could incorporate the provisions of HB 162 and SB 228. Chapter 2 of this report shows that the court system is at risk of not collecting debts. Chapter 3 shows that Medicaid is at risk of both making improper payments and not collecting debts. Chapter 4 shows that unenforced child support orders cause the state to pay more than necessary in Medicaid and other programs.

In establishing requirements at the state level, the emphasis should be on saving and collecting state money and using federal funds to collect money for the state.

Recommendation 5.2

State agencies identified by the statewide work group on risk assessment as being most at risk of making improper or unnecessary payments from state funds or not collecting debts that affect the state's fiscal condition should take specific actions:

- **Assign responsibility to a senior official, such as the chief operating officer or the chief financial officer, for establishing policies and procedures for assessing agency and program risks of improper and unnecessary payments and not collecting debts; taking actions to reduce improper**

and unnecessary payments and collect debts; and reporting the results of the actions to agency management for oversight and other action as deemed appropriate;

- **Develop detailed action plans to determine the nature and extent of improper and unnecessary payments and uncollected debts for all agency programs and/or activities involving state funds;**
- **Identify cost-effective control activities to address identified risk areas that can result in improper or unnecessary state payments or uncollected state debt; and**
- **Periodically report to the agency head and the Finance and Administration Cabinet on the progress made in achieving improper and unnecessary payment reduction targets and debt collection targets and future action plans for controlling improper and unnecessary payments and collecting debts.**

Recommendation 5.3

The Court of Justice should take specific actions:

- **Assign responsibility to a senior official in the Administrative Office of the Courts (AOC) for establishing policies and procedures for assessing the risk that debts will not be collected, taking actions to collect debts, and reporting the results of the actions to AOC management for oversight and other actions as deemed appropriate;**
- **Develop a detailed action plan to determine the extent of uncollected debts;**
- **Identify cost-effective methods to collect debts; and**
- **Periodically report to the Chief Justice of the Supreme Court and the Executive Director of AOC on the progress made in achieving debt collection targets and future action plans for collecting debts.**

Specific Guidance Should Be Issued

The federal joint work group is developing specific agency guidance that provides a comprehensive approach to reducing improper payments. The Government Accountability Office has recommended that any guidance developed for federal agencies include a method for determining error rates, dollar estimates, and the format for agencies to report improper payments.

Specific guidance should include a method for determining error rates, dollar estimates, and the format for reporting on improper payments.

Similar guidance can be issued for state agencies and the court system in Kentucky. Medicaid has been successful in preventing improper payments by identifying other parties that are liable for the cost of services and by using controls in the claims-processing system. However, improper payments continue to be made because of errors and fraud. Medicaid has no formal methods for determining error rates and dollar estimates of improper payments or for reporting improper payments.

State agencies are not required to share information on improper payments.

The Cabinet for Health and Family Services has no formal methods for determining the effect of unenforced child support orders on other state programs, such as Medicaid, the Kentucky Transitional Assistance Program, and public school funding. State agencies are not required to share information with each other regarding improper payments or actions by one agency that can affect other agencies. State agencies also are not required to submit formal reports about improper and unnecessary state payments, such as those caused by unenforced child support orders.

Finance is required to report on debts resulting from improper payments but is not required to include information on error rates and dollar estimates of improper payments.

HB 162 and SB 228 require Finance to provide reports on the amount, type, and age of debts referred by state agencies for collection; the amounts collected; and the amounts deemed not cost-effective to collect. The reports must include information on debts resulting from improper payments and other debts. However, Finance is not required to include information on error rates and dollar estimates of improper payments. Nor is Finance required to collect information and report how action or inaction by one agency affects other agencies. This information could be used in making decisions regarding allocation of resources to agency programs.

Recommendation 5.4

The Finance and Administration Cabinet and the State Budget Director should issue specific guidance to agencies that provides a comprehensive approach to reducing improper payments and collecting debts. The approach should consider how action or inaction by some programs and activities affects other programs and activities. The guidance should include a method for determining error rates and dollar estimates of improper payments. The guidance should also specify the format and content of agency reports on improper and unnecessary payments. Finance should require state agencies to submit the reports by a specified date each year.

Recommendation 5.5

The General Assembly should consider requiring the Finance and Administration Cabinet to report annually on state agencies' improper and unnecessary payments. The report should include information on error rates, estimates of improper payments, and estimates of unnecessary payments caused by the action or inaction of state agencies.

Action Plans Must Be Implemented

A cost-benefit analysis should consider available federal funding.

SB 228 requires Finance to develop for state agencies a system of internal controls and preaudit policies and procedures to prevent and detect errors, fraud, and abuse before a check or warrant is issued. Recommendation 5.2 would require state agencies to develop detailed action plans to determine the nature and extent of improper and unnecessary payments and uncollected debts involving state funds. It also would require state agencies to identify cost-effective control activities to address identified risk areas that result in improper and unnecessary payments or uncollected debt. Implementation will require resources. A cost-benefit analysis should consider the amount of federal funding available for these activities.

Finance officials should offer their expertise to agency staff.

State agency staff may not have the necessary expertise to implement the detailed action plans and internal control and preaudit policies and procedures envisioned in HB 162, SB 228, and the recommendations presented in this chapter. Financial experts in Finance and the Office of the State Budget Director can provide valuable assistance to state agencies in implementing their responsibilities.

Recommendation 5.6

The Finance and Administration Cabinet and the State Budget Director should work with state agency officials to help them implement the action plans and internal controls and preaudit policies and procedures developed to reduce improper and unnecessary payments and to collect debts.

All Available Collection Methods Should Be Considered

Credit card receipts produce immediate money to the state. State agencies and the courts should accept credit card payments.

Credit card receipts produce immediate money to the Commonwealth. That money can earn interest or be used for other essential state purposes. Any subsequent collection of unpaid debt falls to the credit card company rather than to the state.

State agencies and the Court of Justice should accept credit card payments. The Government Finance Officers Association recommends that license fees be considered for electronic payment. In all state agencies and the courts, particular attention should be focused on the potential for additional interest income and the likelihood of reducing accounts receivable. When possible, state agencies and the Court of Justice should enable debtors to pay by credit card on state Internet sites.

Finance should explore the use of all available collection methods.

Because debts that are hard to collect will be referred to Finance, the cabinet should explore the use of all available collection methods, including, but not limited to, liens against assets; garnishment of wages, retirement benefits, and bank accounts; referral to credit reporting agencies; and the use of collection agencies.

Finance may supplement its collections by using collection agencies.

According to the state controllers' survey, 47 states, including Kentucky, are authorized to use collection agencies, but the actual extent of use could not be determined from the survey results (National Association). As state entities in Kentucky implement HB 162 and SB 228, Finance may find that it can supplement its collections by using private collection agencies.

Debtors should not be allowed to obtain or renew licenses and permits.

Finance should also coordinate activities with other state agencies by obtaining information on state-issued professional licenses, business licenses and permits, motor vehicle licenses, drivers' licenses, and recreational licenses, and seek authority to prohibit renewal of licenses for failure to pay debts owed to the state.

One state identified 3,400 professional license holders who collectively owed $3.2 million in delinquent accounts to the state.

Colorado's state auditor has reported on the practices of states to collect debts that are owed to them (State of Colorado). Delaware revokes business licenses for unpaid debts owed to the state. Maryland, Minnesota, and Missouri prohibit renewal of professional licenses for failure to pay state income taxes. Kansas is seeking statutory authority to deny professional license renewals to individuals who fail to pay taxes or fail to file a tax return. The Colorado state auditor identified about 3,400 active license holders who collectively owed $3.2 million in delinquent accounts to the state.

Recommendation 5.7

The Finance and Administration Cabinet, the State Budget Director, the State Treasurer, and the Court of Justice should explore the use of all available collection methods and require or seek authority to require state agencies and the courts to implement all cost-effective methods. The cost-benefit analysis should consider the extent to which the federal government will participate in the cost of collection.

The Central Collection System Should Be Based on Best Practices From Other States

Kentucky can use available knowledge and experience in developing its central state collection system.

The Colorado state auditor's report also described the typical characteristics of a central state collection system:

- A hierarchy for determining which state agency, program, and/or fund is entitled to collections;
- Controls to ensure that payments received are processed and posted in a timely manner to debtors' accounts; are reconciled each month to amounts deposited in the state's bank account; and are divided into component parts, such as principal, interest, and collection fee;
- Transaction codes that identify the type of payment (such as cash, check, credit card, tax intercept, vendor offset, or garnishment), the payment fields (principal, interest, and collection fee), and adjustments (such as amounts reduced by the courts or amounts written off as uncollectible);
- Policies and procedures for retention and storage of documentation to enable staff to respond to inquiries from agencies, the courts, and debtors;
- Security against unauthorized access to protect debtor privacy and reduce the potential for errors and fraud;
- Parameters for assigning priorities to the workload of accounts for each collector based on the potential for collections that benefit the state (e.g. newer accounts with higher dollar balances owed the state and with debtor telephone numbers and Social Security numbers could receive a high priority); and

The system should be able to demonstrate the effectiveness of its recovery efforts.

- A method for demonstrating the effectiveness of its recovery efforts to the state legislature (e.g. calculating the rate based on the dollars collected over time as a percentage of the original related debtor accounts placed during a specific period) (State of Colorado).

Other states have a wealth of knowledge and experience that Kentucky should draw on to develop its system for collecting debts.

Recommendation 5.8

The Finance and Administration Cabinet should research best practices of other states with central collection units to gain the benefit of their knowledge and experience. The system developed by Finance should include appropriate practices, including the requirements of HB 162 and SB 228 and the recommendations in this chapter.

Develop a Statewide Policy for Deposits

Depositing collections sooner results in more interest income to the state.

KRS 41.070(1) specifies that deposits shall be made "in the most prompt and cost-efficient manner available," but Kentucky has no specific statewide policy for depositing funds to the State Treasury. Program Review staff were unable to determine the extent, if any, to which state agencies fail to make deposits as soon as possible after collecting money. Depositing collections sooner results in additional interest income to the state. A statewide policy for requiring same-day deposits could increase the state's interest income.

Recommendation 5.9

The Finance and Administration Cabinet and the State Treasurer should develop a statewide policy to ensure that collections are deposited on the day they are received.

Works Cited

Barnow, Burt, Timothy Dall, Mark Nowak, and Barbara Dannhausen. *The Potential of the Child Support Enforcement Program to Avoid Costs to Public Programs: A Review and Synthesis of the Literature*. Prepared for the United States Department of Health and Human Services, Contract No. HHS-100-97-0007. April 2000. <http://www.acf.hhs.gov/programs/cse/rpt/cs_cost_avoidance_finalrpt.pdf > (accessed May 11, 2004).

Commonwealth of Kentucky. Auditor of Public Accounts. "Letter from the Auditor of Public Accounts, Cabinet for Health Services, In Reference to the Statewide Single Audit of the Commonwealth of Kentucky: For the Year Ended June 30, 2003." <http://www.kyauditor.net/public/Audit_Reports/Archive/ 2003HealthServicesLetter.pdf> (accessed July 7, 2004).

---. Legislative Research Commission. Program Review and Investigations Committee. *Department for Social Insurance Eligibility Determination Process*. Research Report No. 277. Frankfort: LRC, 1997. < http://lrc.ky.gov/lrcpubs/rr277.pdf> (accessed May 11, 2004).

---. ---. ---. *Improving Fiscal Accountability and Effectiveness for Services in the Kentucky Transitional Assistance Program*. Research Report No. 321. Frankfort: LRC, 2004. <http://lrc.ky.gov/lrcpubs/RR%20321.pdf> (accessed July 6, 2004).

---. ---. ---. *The Seek Formula for Funding Kentucky's School Districts: An Evaluation of Data, Procedures, and Budgeting*. Research Report No. 310. Frankfort: LRC, 2002. <http://lrc.ky.gov/lrcpubs/Rr310.pdf> (accessed May 18, 2004).

---. Kentucky State Treasury. Telephone conversation with staff member on April 16, 2004.

Farino, Anthony. "Pharmaceutical Pricing Explained." Pharma Congress Spring 2003 Forum. June 8, 2003. <http://www.ehcca.com/presentations/pharmacongress20030609/ farino_pre.pdf> (accessed June 14, 2004).

Fender, Lynn and Jen Bernstein. *State Practices in Medical Child Support Cross-Program Coordination*. Prepared for the U.S. Department of Health and Human Services. Contract No. 100-99-0003. June 2003. <http://www.aspe.hhs.gov/hsp/ CSE-medsupp03/index.htm> (accessed May 25, 2004).

Formosa, Carl. *Child Support Enforcement: Net Impacts on Work and Welfare Outcomes Pre- and Post- PRWORA*. State of Washington: Washington State Division of Child Support. September 13, 2000. <http://www1.dshs.wa.gov/pdf/esa/dcs/reports/ csepolicybrief.pdf> (accessed May 12, 2004).

Garasky, Steven, Shao-Hsun Keng, and Helen H. Jensen. *Child Support Cost Avoidance: Evidence from Iowa*. Prepared for U.S. Department of Health and Human Services. Contract No. 105-00-8303. June 6, 2003. <http://www.acf.hhs.gov/programs/cse/pubs/2003/reports/cost_avoidance/> (accessed May 6, 2004).

Government Finance Officers Association. *GFOA Recommended Practice: Electronic Transactions for State and Local Governments*. 2002. <http://www.gfoa.org/services/rp/cash/cash-electronic-transactions.pdf> (accessed May 12, 2004).

Kaplan, Thomas and Ingrid Rothe. *Medical Support Orders: Potential Fiscal Effects of Matching Wisconsin Insurance and Child Support Data*. University of Wisconsin-Madison: Institute for Research on Poverty, January 2003. <http://www.ssc.wisc.edu/irp/childsupp/medical_support_orders.htm> (accessed May 27, 2004).

Lacker, Jeffrey. "The Check Float Puzzle." *Economic Quarterly* 83.3. Summer 1997.

Laudan, Aron. *Health Care Coverage Among Child-Support Eligible Children*. Prepared for the U.S. Department of Health and Human Services. Contract No. 100-99-0003. December 2002. <http://aspe.hhs.gov/hsp/CSE-health-ben02/> (accessed May 6, 2004).

Matthias, John T.; Gwendolyn H. Lyford, and Paul C. Gomez. *Current Practices In Collecting Fines and Fees In State Courts: A Handbook of Collection Issues and Solutions.* Williamsburg, Virginia: National Center for State Courts, Court Services Division, 1995.

Morgan, Marcia, Secretary of the Cabinet for Health Services, Commonwealth of Kentucky. "Kentucky's Roadmap in Closing the Gap." Presentation to the Foundation for a Healthy Kentucky Forum on Kentucky Medicaid Decision Making in Tough Times. September 8, 2003. <http://www.healthyky.org/PDFs/Marcia%20Morgan.pdf> (accessed June 7, 2004).

National Association of State Auditors, Comptrollers, and Treasurers. *State Comptrollers: Technical Activities and Functions, 2000*. Lexington, Kentucky. 2000.

National Center for State Courts. *Enforcement of Monetary Sanctions Imposed by the Courts: Statewide Collection Programs*. December 30, 2003. http://www.ncsconline.org/Projects_Initiatives/BPI/MonetarySanctions.htm> (accessed June 14, 2004).

---. "Collection of Fines and Costs: Frequently Asked Questions." December 30, 2003. <http://www.ncsconline.org/WC/FAQs/KIS_ColFinFAQ.pdf> (accessed June 14, 2004).

National Governors Association. *Addendum to State Initiatives to Promote Cost-Effective Use of Pharmacy Benefits*. August 14, 2000. <http://www.nga.org/cda/files/PHARMSTRATEGIES.pdf> (accessed June 7, 2004).

---. *States Partner for Greater Discounts on Medicaid Drugs*. March 6, 2003. <http://www.nga.org/center/frontAndCenter/1,1188, C_FRONT_CENTER^D_5139,00.html> (accessed June 7, 2004).

Roberts, Paula. *Failure to Thrive: The Continuing Poor Health of Medical Child Support*. Center for Law and Social Policy. Publication No. 03-34. June 2003. <http://www.clasp.org/DMS/Documents/1054585921.0/failure_to_thrive.pdf> (accessed May 20, 2004).

Roberts, Paula and Michelle Jordan. *State Policy Regarding Pass-Through and Disregard of Current Month's Child Support Collected for Families Receiving TANF-funded Cash Assistance*. Center on Law and Social Policy. Publication No. 04-06. December 2003. <http://www.clasp.org/DMS/Documents/1076098930.07/ pass_thru2.pdf> (accessed May 20, 2004).

State of Colorado. State Auditor. *Central Collection Services, Department of Personnel and Administration*. Denver: State Auditor, May 2004. <http://www.leg.state.co.us/OSA/coauditor1.nsf/All/1F5F58E8573AC0BA87256EAE00604528/$FILE/1555%20Central%20Collections%20Perf%20May%202004.pdf > (accessed June 18, 2004).

State of Indiana. Indiana Health Coverage Programs. *Most Common Billing Unit Discrepancies That Result in Manufacturer Drug Rebate Disputes*. Provider Bulletin 200222. Indianapolis: Indiana Health Coverage Programs; May 27, 2002. <http://www.indianamedicaid.com/ihcp/Bulletins/bt200222.pdf> (accessed June 7, 2004).

State of Maine. "Frequently Asked Questions – Traffic Violations." June 8, 2004. <http://www.courts.state.me.us/faq/violations/notcontesting.html> (accessed June 18, 2004).

State of Nevada. Legislative Auditor. *Judicial Branch of Government Administrative Oversight of the State Court System*. Carson City: Legislative Auditor, 2002.

United States. Federal Reserve Bank. *Retail Payments Research Project: A Snapshot of the U.S. Payments Landscape*. Washington, D.C.: Federal Reserve System, 2001. <http://www.frbservices.org/Retail/pdf/RetailPaymentsResearchProject.pdf> (accessed May 4, 2004).

---. Department of Health and Human Services. *Review of the Ability of Non-Custodial Parents to Contribute Toward the Medical Costs of Title IV-D Children in Connecticut That Were Paid Under the Medicaid Program*. May 15, 2003. (Reports were also issued for Indiana, New Jersey, New York, North Carolina, Texas, and Virginia.) <http://www.oig.hhs.gov/oas/reports/region1/10202502.pdf> (accessed May 8, 2004).

---. ---. Administration for Children and Families. *21 Million Children's Health: Our Shared Responsibility*. August 10, 2000. <http://www.acf.hhs.gov/programs/cse/rpt/medrpt/> (accessed May 12, 2004).

---. ---. Office of Inspector General. *State Strategies to Contain Medicaid Drug Costs*. OEI-05-02-00680. October 2003. http://www.oig.hhs.gov/oei/reports/oei-05-02-00680.pdf (accessed May 19, 2004).

---. ---. ---. *Review of Availability of Health Insurance for Title IV-D Children*. A-01-97-02506. Boston, MA: Office of Audit Services. June 1998. <http://www.oig.hhs.gov/oas/reports/region1/19702506.pdf> (accessed May 11, 2004).

---. General Accounting Office. *Financial Management: Billions in Improper Payments Continue to Require Attention*. GAO-01-44. October 2000. <http://www.gao.gov/new.items/d0144.pdf> (accessed May 12, 2004).

Ward, Karla. "State Wants to Rein in Drug Costs." *Lexington Herald-Leader.* February 13, 2004. B3.

Wheaton, Laura. *Cost Avoidance and Cost Recovery in California's Child Support Program: SFY 2000-2001*. Report prepared for the Child Support Directors of California. February 27, 2004. Washington, D.C.: Urban Institute. <http://www.urban.org/urlprint.cfm?ID=8779> (accessed May 14, 2004).

---. *Non-Resident Fathers: To What Extent Do They Have Access to Employment-Based Health Care Coverage?* Prepared for the U.S. Department of Health and Human Services. Contract No. HHS-100-95-0021. June 2000. <http://fatherhood.hhs.gov/ncp-health00/> (accessed May 10, 2004).

Wheaton, Laura and Elaine Sorenson. *Reducing Welfare Costs and Dependency: How Much Bang for the Child Support Buck?* Washington, D.C.: Urban Institute, 1998. <http://www.urban.org/UploadedPDF/gppr_final.pdf> (accessed May 11, 2004).

Appendix A

The Risk-assessment Process for This Study

The emphasis of this study was saving and collecting state money.

Throughout this study, Program Review staff considered the risk that improper payments may be made or that debts may not be collected. The emphasis of the study was on saving and collecting state money. Staff focused primarily on programs and activities that could potentially produce millions of dollars in collections or savings for the Commonwealth.

The risk assessment that this report used was based on information obtained from Legislative Research Commission staff, state agencies, local officials, university officials, associations, and federal agencies.

Staff interviewed and obtained information from many sources:

- Staff of the Legislative Research Commission's Budget Review Office, Office of Constituent Services, Staff Economists Office; and staff of the Appropriations and Revenue, Health and Welfare, and Contract Review Committees;
- Officials of the Finance and Administration Cabinet, Office of the State Auditor of Public Accounts, Kentucky State Treasury, Office of State Budget Director, Office of the Attorney General, Cabinet for Health and Family Services, Transportation Cabinet, Administrative Office of the Courts, Council on Postsecondary Education, Department of Education, Commerce Cabinet, Tourism Development Cabinet, and Environmental and Public Protection Cabinet;
- The Webster County Attorney, staff of the Franklin County District Court, the Franklin County Circuit Court Clerk, the Christian County Circuit Court Clerk, and staff from the Anderson County Office of Community Based Services;
- Officials of the University of Kentucky, the University of Louisville, and Murray State University;
- Staff of the Kentucky Hospital Association and the Kentucky Association of Homes and Services for the Aging;
- Staff of the U.S. Government Accountability Office, U.S. Office of Management and Budget, Federal Emergency Management Agency, and Centers for Medicare and Medicaid Services; and
- Staff of the National Conference of State Legislatures; the National Center for State Courts; and the National Association of State Auditors, Comptrollers and Treasurers.

Reports were reviewed to identify programs that others had found to be at risk of making improper payments or not collecting debts.

Program Review staff reviewed audit and evaluation reports from all U.S. states and the federal government to identify programs and agencies that others had found to be at risk of making improper payments or not collecting debts, revenue, and other amounts owed, such as drug rebates from pharmaceutical companies. These reports were obtained from Web sites of the U.S. Government Accountability Office; the National Conference of State Legislatures; and the National Association of State Auditors, Comptrollers and Treasurers. Staff's review indicated that the court system was likely to be at high risk of not collecting debts. The review also indicated that Medicaid was likely to be at high risk of both making improper payments and not collecting debts. The review also indicated that unenforced child support orders cause unnecessary costs for other state programs.

State and federal laws, regulations, and policies for preventing improper payments and collecting debts were reviewed.

Staff reviewed state and federal laws, regulations, and policies for preventing improper payments and collecting debts. As this study was being conducted, HB 162 and SB 228 were enacted. These new laws amend existing statutes and specify procedures for state entities to prevent improper payments and to collect debts.

Incentives to recover overpayments of federal funds were considered.

For programs with legislative or regulatory eligibility criteria, improper payments indicate that agencies are spending more than necessary. Conversely, for programs with fixed funds, any waste of funds translates into serving fewer recipients or accomplishing less than could be expected. The incentives from the federal government to the state for preventing and collecting overpayments vary among programs. Some federal programs allow the state to keep a percentage of collections. Others require the state to use the collections in the program, which can expand services to existing recipients or extend services to more people. In programs with a federal component, the federal government normally pays part of the collection cost by providing funding for administrative expenses.

Procedures for drawing down federal funds were reviewed.

Staff reviewed state agencies' procedures for drawing down federal funds in reimbursement grants. The purpose of the review was to determine whether the state could be losing interest income by not requesting and depositing federal funds as soon as possible.

Federal reimbursement grants require the state to spend its own funds and then request reimbursement from the federal government for some or all of the cost. Medicaid is the state's largest reimbursement grant program. Medicaid spent more than $2.7 billion in federal funds in FY 2003. The procedures for drawing down federal funds are governed by an agreement

between the U.S. Treasury and the Commonwealth. The agreement specifies that the state may request federal funds the same day it pays out state funds for Medicaid benefits. Officials in the Cabinet for Health and Family Services monitor the daily clearance of Medicaid payments through the state's bank account and draw down federal funds the same day. As a result, Medicaid was determined not to be at risk of causing the state to lose interest income from federal reimbursements.

Nontax revenue sources, such as charges for goods and services, were considered.

Staff considered state agencies' nontax revenue sources, such as charges for goods and services, to determine whether revenues are likely to be collected in the normal course of business. Staff also reviewed the results of a survey conducted by the Revenue Cabinet (now a department in the Finance and Administration Cabinet) in the summer of 2003 regarding state agencies' collection policies and procedures. Based on these combined procedures, staff determined that state agencies typically collect revenue in the normal course of business because of the nature of the exchange transactions. The agency receives payment when the goods or services are provided to the customer. As a result, most agencies were not considered to be at high risk of not collecting significant amounts owed.

Public universities' accounts receivable were considered.

Staff considered public universities' accounts receivable. Staff received information from the University of Kentucky, the University of Louisville, Murray State University, and the Council on Postsecondary Education. Based on that information, the state's public universities were not considered to be at high risk for not collecting debts.

Noncurrent accounts receivable were emphasized.

Noncurrent, nontax accounts receivable, which totaled $121 million as of June 30, 2003, were analyzed in this study. State agencies report accounts receivable to the Finance and Administration Cabinet at the end of the fiscal year for use in preparing the state's comprehensive annual financial report. Noncurrent receivables identified by the agencies are not expected to be collected for an extended period after the end of the fiscal year. Staff considered whether the extended collection period was caused by inattention to collections or other factors. Many noncurrent receivables are caused by the underlying nature of the transactions and events and are beyond the agencies' control. For example, the Federal Emergency Management Agency (FEMA) will not pay some expenses of clean up and restoration after a natural disaster until a completed project is inspected by FEMA. The FEMA inspector often has competing demands for his or her time and may not be able to inspect a project until some time after

it has been completed. Although FEMA will make progress payments on a large project, the final payment may not be received by the state until some time into the future. This process is beyond the state's control. Other noncurrent receivables, such as disputed amounts in Medicaid's drug rebate program, could be collected more quickly or could be written off as uncollectible if the disputes were resolved in a timely manner.

Current accounts receivable were considered but not emphasized.

Current accounts receivable, on the other hand, are normally collected soon after the end of a fiscal year and were not emphasized in this study. The measurement of current accounts receivable and accounts payable on June 30 captures a snapshot of many transactions in process. There are millions of dollars in accounts receivable reported in the state's comprehensive annual financial report, but that does not mean that additional cash is available to the state that was not already expected.

Consider the following example. On Monday, June 30, 2003, Medicaid had millions of dollars of accounts receivable and accounts payable. The reason is the timing of the measurement. Providers' claims were adjudicated on Friday, June 27. At that time, the amount owed to the providers (accounts payable) and the amount due to the state from the federal government for its share (accounts receivable) were measured. Medicaid reported the June 30 payables and receivables to the Finance and Administration Cabinet for use in preparing the comprehensive annual financial report. During the first week of the new fiscal year, which began on Tuesday, July 1, most of the payments to the providers cleared the state's bank account and thus eliminated the accounts payable. Medicaid drew down federal funds to reimburse the state for paying the providers, which eliminated the accounts receivable. As this example shows, total receivables at June 30 may be significant, but most of the balances are attributable to ordinary transactions in process.

The extent to which customers can pay the state by credit card was explored.

Staff considered the time value of money. The detailed analysis is presented in Appendix B. In particular, staff considered the extent to which customers can pay the state by credit card or other electronic means. Some agencies allow customers to pay by credit card, and others have been encouraged to do so. The acceptance of electronic payments results in deposits to the state's bank account more quickly, which can produce additional investment income to the state and can reduce the cost of debt collection after the fact.

The extent to which entities receiving state funds are audited was considered.

Staff considered how and when entities receiving state funds are audited. Some entities, such as local school districts that receive state and federal funds, have an annual audit of their financial statements and compliance with federal program requirements. These entities were not considered significant to the study objectives because of (1) the requirements for annual audits and (2) state agencies' responsibilities for monitoring payments to these entities. Any overpayment of state funds to local entities is the responsibility of the state agency. Therefore, staff focused attention on state agencies and the courts.

Finally, staff working on this report avoided duplicating work being done by others. As this study was being conducted, Program Review staff and other state agencies were performing related work. Program Review staff were examining the Kentucky Transitional Assistance Program and the use of state computers. The State Auditor of Public Accounts has been asked by the Corrections Department to investigate undeposited collections at Correctional Industries and to conduct a two-year financial audit. That office has also audited state agencies' use of procurement cards. The Finance and Administration Cabinet is focusing increased attention on controls over procurement cards, travel, cell phone usage, and other administrative expenses. The Attorney General is investigating potential fraud against the Medicaid program. The work of these other groups can be used to supplement this report.

Appendix B

Strategies To Contain Medicaid Drug Costs

In 2003, the U.S. Department of Health and Human Services' Office of Inspector General reported the strategies states use to contain Medicaid drug costs. Kentucky has implemented several of the cost-containment initiatives, which are described in this appendix. Two new laws to help monitor and control drug use in Kentucky are also discussed.

Kentucky limits prescription drug utilization by placing restrictions on the number of refills. Additional restrictions are placed on refills of controlled substances.

Under federal Medicaid guidelines, states may limit prescription drug utilization. Kentucky and 43 other states limit prescription drug use by placing restrictions on the number of prescriptions per month for each Medicaid recipient, the amount of medication per prescription, or the number of refills.

Since May 25, 2004, Kentucky has placed limits on the number of refills of Schedules III, IV, and V controlled substances. Refills are limited to five within a six-month period from the date the prescription was written or ordered. Less stringent controls are imposed on refills of noncontrolled substances, which may be refilled 11 times within a 12-month period from the date the prescription was written or ordered.

Kentucky and 28 other states use prior authorization as a centralized cost-containment measure. Kentucky has used prior authorization of costly drugs since December 2002. The state requires providers to obtain prior authorization from the Medicaid agency before dispensing a particular drug or class of drugs. Medicaid responds to providers' requests for prior authorization within 24 hours. Because some situations demand immediate action, pharmacies are required to dispense a 72-hour supply of the drug to the beneficiary in an emergency situation.

The Pharmacy and Therapeutics Advisory Committee makes recommendations for requiring prior authorization of certain drugs.

Kentucky's Pharmacy and Therapeutics Advisory Committee makes recommendations to Medicaid to place selected costly drugs on a prior-authorization list when the use of the drug presents a financial burden to the state or poses a significant safety issue. The committee advises the governor, the secretary of the Cabinet for Health and Family Services, and the commissioner of the Department for Medicaid Services on the development and administration of an outpatient drug formulary. Some examples of costly drugs placed on prior authorization include Prozac, an anti-depressant; Celebrex, an anti-inflammatory drug; and Singulair, a

drug to treat asthma and allergies. Prior authorization is always required for brand-name drugs for which generic forms are available.

Kentucky requires the use generic drugs when available.

Kentucky's Medicaid program requires generic drugs to be used when available as a way to contain pharmacy costs. Kentucky excludes coverage of brand-name drugs in the Medicaid program when the U.S. Food and Drug Administration (FDA) has approved a generic product, unless a prior authorization is received and/or the physician deems the brand-name drug medically necessary.

Kentucky uses a preferred drug list.

Kentucky and 19 other states also use preferred drug lists as a tool to contain Medicaid pharmacy costs. States must cover all drugs produced by manufacturers with drug rebate agreements, provided the FDA has approved the drugs. However, states can encourage the use of preferred drugs, so long as nonpreferred drugs are available through prior authorization. The use of a preferred drug list changes prescribing behavior of Medicaid providers. Because many providers do not want to go the effort of obtaining prior authorization if unnecessary, a drug company has an incentive to get its drugs on Medicaid's preferred drug list.

Kentucky's Pharmacy and Therapeutics Advisory Committee authorized and implemented a preferred drug list in November 2001. The committee continuously makes recommendations as to which drugs should be added to or removed from the list.

Kentucky has a supplemental drug rebate agreement. The additional amount the state will receive cannot be determined at this time.

Drug manufacturers may agree to provide states with supplemental rebates in addition to the federally mandated rebates. In return, the manufacturers' drugs are included on the state's preferred drug list. Kentucky hired a vendor, Provider Synergies, in August 2003 to negotiate supplemental rebates. The additional amount the state will receive under the supplemental agreement cannot be determined at this time.

States are permitted by federal law to require nominal cost sharing or co-payments from Medicaid recipients, up to $3 a prescription. Pharmacists may not withhold a drug from a recipient who cannot afford to pay the co-payment.

Kentucky requires co-payments in some circumstances.

Kentucky has had a $1 Medicaid co-payment per prescription since August 2002 and a $2 co-payment on optional services, such as dental and optometry, since May 2003. Medicaid officials stated that children and pregnant women are not required to pay the co-payment. The Kentucky Children's Health Insurance Program

imposes a $1 co-payment per prescription in addition to a $20 per month premium per family.

Federal Medicaid law requires states to perform drug utilization reviews to examine the appropriateness, quality, and medical necessity of drug use. In addition to improving quality of care, drug utilization review can result in cost savings by reducing medically inappropriate drug use.

Kentucky's Drug Utilization Program can identify dangerous situations involving drug use and notify the physician or pharmacist.

Kentucky's Drug Utilization Program, implemented in 1994, has the capability to indicate potential danger, such as the overuse of drugs, and send an alert to the patient's physician or pharmacist. Other problems identified in a drug utilization review include drug-disease conflicts, in which the prescribed medication is inappropriate for the patient's illness; patients using two or more drugs that could have dangerous side effects; and patients not taking adequate amounts of medication. In 1999, Kentucky's Drug Utilization Program sent 2,813 alert letters to physicians and 3,318 alert letters to pharmacists.

Laws were enacted in 2004 to help state officials monitor and control drug use. SB 40 allows Medicaid to identify recipients who should be assigned to a single physician or pharmacy to control drug use. SB 14 increases the availability of data and reporting on drug use.

During the 2004 regular session, the General Assembly enacted Senate Bills 40 and 14 to help state officials monitor and control drug use. The laws expand the use that can be made of information in the Kentucky All-Schedule Prescription Electronic Reporting (KASPER) system, which is used to monitor Schedules II, III, IV, and V controlled substances.

SB 40 permits Medicaid to use KASPER data to identify recipients whose use of controlled substances may be appropriately managed by a single outpatient pharmacy or primary care physician. The process, referred to as lock in, is designed to prevent a recipient from obtaining prescriptions for controlled substances from multiple doctors and/or having prescriptions filled at multiple pharmacies.

SB 14 permits additional entities to receive KASPER data and requires the Cabinet for Health and Family Services to use KASPER data to produce trend reports on the use of controlled substances in Kentucky. SB 14 also permits the cabinet to enter into reciprocal agreements with other states and requires it to report annually to the governor and the Legislative Research Commission on the status of those agreements.

Judges, law enforcement officers, and licensing boards will be able to obtain information in certain circumstances.

Entities permitted under SB 14 to receive KASPER data include

- the Kentucky Board of Medical Licensure in certain circumstances, such as in an investigation of improper prescribing practices or when a trend report indicates inappropriate prescribing is likely in a geographical area;
- a judge or probation or parole officer administering a diversion or probation program of a criminal defendant arising out of a substance abuse violation; and
- law enforcement officers engaged in a bona fide special investigation involving a designated individual.

In addition, Medicaid may share data on overutilization by recipients with a licensure board or with a law enforcement officer. The Cabinet for Health and Family Services is required to work with each affected board, the Kentucky Bar Association, and the Justice Cabinet to develop continuing education programs on the purposes and uses of KASPER.

SB 14 allows more information on prescription drug use to be developed and made available to those who need it to help control excessive prescribing, excessive utilization, and criminal activity.

Appendix C

The Medicaid Drug Rebate Process

The Medicaid drug rebate process involves interaction among various drug manufacturers and wholesalers, pharmacies, the U.S. Centers for Medicare and Medicaid Services (CMS), and state Medicaid agencies.

Medicaid is responsible for sending invoices to drug manufacturers and collecting the rebates.

Medicaid is responsible for sending invoices to drug manufacturers for rebates and collecting the due amount. Kentucky's Medicaid program relies on data provided by pharmacies and CMS to calculate the amount due. Medicaid's fiscal agent, Unisys, performs the calculation.

Manufacturers are required to supply their products to Medicaid at the lowest prices offered to other purchasers.

The drug rebate agreement between manufacturers and the federal government requires manufacturers to supply their products to state Medicaid programs at the lowest prices at which the drugs are offered to other purchasers. In most states, pharmacies purchase drugs through their normal distribution channels, dispense the prescriptions to Medicaid recipients, and bill the state Medicaid agency for the cost of the drug plus a dispensing fee.[1] Drug manufacturers sell their products to wholesalers who in turn sell the drugs to local retail pharmacies. The pharmacies dispense the drugs to Medicaid recipients and send the utilization data (the amount of each type of drug dispensed to Medicaid recipients) to Medicaid for reimbursement.

The drug utilization data are multiplied by the unit drug rebate amounts to calculate the rebate amount to invoice.

The drug utilization data provided to Medicaid by the pharmacies are multiplied by the unit drug rebate amounts provided by CMS to calculate the rebate amount due. CMS provides unit rebate amount information to states on a quarterly basis. The rebate amount varies depending upon whether the drug is brand name or generic. The following terms are defined to better understand the drug unit rebate amount:

The "best price" (BP) is the lowest price available from the manufacturer during the rebate period to any wholesaler, retailer, provider, health maintenance organization, nonprofit entity, or governmental entity within the United States.

[1] In Kentucky, Medicaid pays pharmacies a dispensing fee of $4.51 minus a $1 recipient co-pay. Therefore, a pharmacy may bill Medicaid for the cost of the drug plus $3.51.

The "average manufacturer's price" (AMP) is the average unit price that is paid to a manufacturer for its drug in the United States.

The "consumer price index" (CPI) is a monthly measure of the average change in the prices paid by urban consumers for a fixed market basket of goods and services. The medical component of CPI shows trends in medical care prices based on specific indicators of hospital, medical, dental, and drug prices.

The unit rebate amount for generic drugs is a flat 11 percent of the average price. The unit rebate amount for name brand drugs must be calculated using a specified formula.

The unit rebate amount for generic drugs is 11 percent of the average manufacturer's price. The formula for calculating the unit rebate amount for name brand drugs consists of two steps.

Step 1: The **basic** rebate is equal to the greater of

(a) 15.1 percent of AMP, or
(b) the difference between AMP and the manufacturer's best price.

Step 2: The **additional** rebate, which adjusts the amount to include the CPI, is calculated following the steps below.

(a) Baseline AMP divided by the baseline CPI.
(b) Answer to (a) multiplied by the quarterly CPI.
(c) Compare the answer to (b) with the quarterly AMP. If the amount is equal to or greater than the quarterly AMP, there is no additional rebate due. If the amount is less than AMP, subtract the amount from the quarterly AMP. The result is the additional rebate owed to the state.

CMS provided the following example of a name brand drug unit rebate calculation:

AMP = .1548
BP = .151

Step 1: Basic Rebate

(a) AMP x 15.1% = .023
(b) AMP - BP = .0038

(a) is greater than (b). Therefore, the basic rebate amount is .023

Step 2: Additional Rebate Amount

(a) Baseline AMP/baseline CPI = .0010236
(b) .0010236 x current quarterly CPI = .157
(c) Answer to (b) is greater than quarterly AMP; therefore, the additional rebate owed to the state = 0.

The unit drug rebate amount therefore equals 0.023

Once the rebate amount has been calculated, Unisys sends invoices to the drug manufacturers and the payment process begins. Drug manufacturers may either pay the full amount billed or dispute all or some of the amount billed. The dispute resolution process with the drug manufacturers is the responsibility of the state's Medicaid program.

Appendix D

Ranking of County Child Support Offices for FY 2004, Cabinet for Health and Family Services

County	% of Cases With Child Support Orders (June 2004)	% of Cases With Established Paternity (June 2004)	Collections as % of Obligations (FY 2004)	Cases Paying Arrears as % of Cases w/ Arrears (FY 2004)	Total of Previous Four Columns	FY 2004 Ranking	FY 2003 Ranking	Change in Ranking (FY 2004 minus FY 2003)
Oldham	93.8	97.4	73.2	43.5	307.8	1	1	0
Harrison	90.5	93.3	68.4	40.5	292.6	2	2	0
Owen	88.7	91.6	68.9	38.5	287.6	3	5	2
Adair	89.1	90.8	67.0	38.9	285.8	4	3	-1
Boone	88.4	87.8	72.8	32.7	281.6	5	4	-1
Larue	83.0	93.0	68.5	32.2	276.7	6	13	7
Allen	84.9	86.0	67.6	36.0	274.4	7	6	-1
Gallatin	82.7	87.7	65.3	37.6	273.2	8	12	4
Washington	82.2	90.0	67.1	31.0	270.2	9	9	0
Green	80.5	90.8	63.2	32.9	267.4	10	7	-3
Trigg	79.0	87.8	63.4	32.6	262.8	11	10	-1
Logan	87.2	91.4	58.0	24.5	261.2	12	11	-1
Nicholas	77.0	86.8	64.2	30.2	258.2	13	46	33
Union	78.5	85.8	64.3	28.3	256.9	14	17	3
Christian	76.8	82.2	63.2	34.6	256.7	15	20	5
Pendleton	77.2	84.8	66.7	26.9	255.6	16	14	-2
Nelson	78.7	87.4	61.1	27.5	254.7	17	27	10
Henry	73.6	84.7	61.8	34.0	254.1	18	15	-3
Harlan	80.1	90.2	57.1	26.1	253.4	19	30	11
Leslie	82.9	94.8	52.9	22.4	252.9	20	50	30
Grant	73.3	86.1	64.9	27.6	251.8	21	25	4
Butler	77.6	88.8	58.1	26.2	250.6	22	36	14
Casey	77.1	86.5	58.8	28.1	250.5	23	24	1
Woodford	74.8	83.0	63.9	27.6	249.3	24	19	-5
Henderson	73.4	83.0	61.3	30.7	248.3	25	26	1
McLean	75.0	83.8	62.9	24.8	246.4	26	18	-8
Marion	72.8	88.9	55.4	27.7	244.8	27	28	1
Crittenden	68.3	86.2	64.7	25.1	244.2	28	32	4
Lyon	69.1	86.8	61.1	27.1	244.1	29	8	-21
Anderson	72.1	77.2	68.2	26.3	243.8	30	47	17
Morgan	75.8	82.0	58.8	27.3	243.7	31	38	7
Powell	74.8	89.9	55.5	23.4	243.5	32	33	1
Breckinridge	69.4	83.6	65.0	25.5	243.5	33	21	-12
Kenton	75.0	80.7	62.9	23.6	242.2	34	39	5
Hart	67.1	83.7	61.6	29.0	241.4	35	41	6

County	% of Cases With Child Support Orders (June 2004)	% of Cases With Established Paternity (June 2004)	Collections as % of Obligations (FY 2004)	Cases Paying Arrears as % of Cases w/ Arrears (FY 2004)	Total of Previous Four Columns	FY 2004 Ranking	FY 2003 Ranking	Change in Ranking (FY 2004 minus FY 2003)
Hart	67.1	83.7	61.6	29.0	241.4	35	41	6
Hardin	74.6	81.4	59.5	25.7	241.2	36	55	19
Franklin	74.9	82.8	59.7	22.9	240.3	37	45	8
Clinton	74.6	82.0	56.6	27.1	240.2	38	16	-22
Caldwell	70.5	82.6	56.9	28.5	238.5	39	37	-2
Grayson	70.6	88.8	58.7	20.2	238.2	40	52	12
Taylor	65.2	83.2	58.3	31.2	237.9	41	57	16
Breathitt	74.1	86.3	51.6	25.6	237.7	42	87	45
Perry	72.9	83.8	55.3	25.5	237.4	43	69	26
Campbell	74.1	77.6	60.6	24.7	237.0	44	23	-21
Simpson	74.0	83.6	56.4	22.9	236.9	45	34	-11
Daviess	75.7	86.7	51.2	22.1	235.7	46	35	-11
Johnson	79.4	89.6	47.0	18.7	234.8	47	62	15
Carroll	74.7	80.2	58.9	20.9	234.7	48	67	19
Livingston	68.8	75.8	62.7	26.5	233.6	49	29	-20
Bell	67.6	79.5	56.4	29.8	233.3	50	31	-19
Trimble	71.3	79.5	61.1	20.9	232.7	51	73	22
Lee	71.1	82.0	47.8	31.6	232.4	52	42	-10
Montgomery	73.3	83.6	54.9	19.9	231.6	53	49	-4
Meade	70.0	81.8	57.5	20.5	229.8	54	58	4
Carter	73.0	83.8	51.8	20.9	229.6	55	54	-1
Pike	75.7	84.1	49.2	20.2	229.2	56	48	-8
Barren	67.6	80.8	56.8	23.3	228.4	57	43	-14
Rowan	68.5	75.0	62.8	21.9	228.2	58	71	13
Ballard	70.8	82.2	56.0	19.1	228.1	59	61	2
Shelby	63.3	77.0	60.6	26.2	227.1	60	77	17
Jessamine	70.5	80.1	52.8	23.6	227.0	61	63	2
Hickman	65.6	82.9	54.3	23.5	226.3	62	66	4
Pulaski	69.1	80.8	55.9	20.4	226.2	63	40	-23
Graves	68.9	82.0	56.3	18.3	225.5	64	44	-20
Hancock	60.2	85.7	58.7	19.4	224.0	65	68	3
Lawrence	71.6	77.8	52.0	21.3	222.7	66	70	4
Fleming	67.1	79.1	54.0	22.0	222.1	67	64	-3
Russell	63.3	77.8	57.4	23.5	222.0	68	59	-9
Bullitt	66.3	73.7	56.2	25.2	221.3	69	78	9
Carlisle	68.4	77.2	54.2	21.1	220.9	70	60	-10
Mason	64.5	77.7	55.4	23.3	220.9	71	51	-20
Rockcastle	71.6	80.7	49.8	18.0	220.1	72	96	24
Wayne	65.4	78.5	51.3	24.4	219.6	73	98	25
Monroe	68.9	78.1	52.3	20.1	219.3	74	106	32

County	% of Cases With Child Support Orders (June 2004)	% of Cases With Established Paternity (June 2004)	Collections as % of Obligations (FY 2004)	Cases Paying Arrears as % of Cases w/ Arrears (FY 2004)	Total of Previous Four Columns	FY 2004 Ranking	FY 2003 Ranking	Change in Ranking (FY 2004 minus FY 2003)
Floyd	67.7	82.0	51.1	17.9	218.8	75	83	8
Cumberland	58.6	82.6	55.8	20.8	217.8	76	103	27
Hopkins	58.1	77.2	53.4	29.1	217.8	77	56	-21
Knott	65.9	81.8	50.7	19.3	217.7	78	91	13
Metcalfe	66.4	81.1	49.2	20.7	217.4	79	22	-57
Madison	65.0	77.0	51.4	23.4	216.8	80	94	14
Clark	63.7	73.5	55.7	23.6	216.5	81	99	18
Lincoln	61.7	74.0	54.2	25.2	215.0	82	65	-17
Fayette	67.5	78.0	49.3	19.6	214.4	83	72	-11
Bracken	57.2	73.4	62.2	21.5	214.3	84	97	13
Martin	67.4	82.0	46.7	18.2	214.3	85	107	22
Menifee	57.9	75.0	56.8	24.6	214.3	86	75	-11
Estill	60.0	77.1	51.9	24.1	213.0	87	74	-13
Ohio	61.2	75.9	51.5	24.5	213.0	88	53	-35
Bath	58.0	69.2	59.8	23.5	210.6	89	92	3
Todd	60.7	69.7	57.5	22.5	210.4	90	82	-8
Boyle	59.3	76.0	52.1	22.1	209.4	91	80	-11
Marshall	61.8	71.1	54.0	21.4	208.3	92	111	19
Bourbon	55.6	70.9	56.6	25.2	208.2	93	90	-3
Letcher	62.5	80.6	47.6	17.3	208.0	94	109	15
Muhlenburg	59.7	78.1	47.7	21.8	207.2	95	76	-19
Robertson	58.9	76.6	52.0	18.6	206.0	96	79	-17
Scott	57.7	69.7	54.4	23.0	204.9	97	86	-11
Wolfe	50.8	76.1	57.9	19.2	203.9	98	85	-13
Greenup	56.4	79.1	50.0	17.6	203.1	99	81	-18
Clay	70.4	76.7	38.0	16.4	201.5	100	84	-16
Warren	60.7	69.5	51.0	20.2	201.3	101	95	-6
Garrard	55.9	63.8	58.3	22.2	200.2	102	102	0
Magoffin	57.8	75.1	46.2	19.3	198.5	103	112	9
Edmonson	51.9	67.2	55.0	24.4	198.5	104	104	0
McCreary	60.3	73.1	43.3	20.9	197.6	105	110	5
Jefferson	55.6	78.7	45.0	17.8	197.2	106	101	-5
Mercer	52.9	65.1	56.5	22.2	196.7	107	89	-18
Lewis	57.3	71.2	46.9	18.8	194.2	108	100	-8
Boyd	57.7	71.2	47.7	17.5	194.1	109	114	5
Webster	50.2	70.0	52.6	18.3	191.2	110	88	-22
Calloway	57.6	64.8	49.9	16.3	188.6	111	116	5
Fulton	61.4	69.8	43.1	14.1	188.4	112	105	-7
Jackson	64.5	61.8	44.1	17.8	188.1	113	108	-5
Elliott	52.3	76.5	40.3	16.8	185.9	114	117	3

County	% of Cases With Child Support Orders (June 2004)	% of Cases With Established Paternity (June 2004)	Collections as % of Obligations (FY 2004)	Cases Paying Arrears as % of Cases w/ Arrears (FY 2004)	Total of Previous Four Columns	FY 2004 Ranking	FY 2003 Ranking	Change in Ranking (FY 2004 minus FY 2003)
McCracken	53.4	69.2	47.7	14.0	184.3	115	113	-2
Knox	50.4	68.3	46.8	18.3	183.8	116	119	3
Spencer	46.2	58.3	56.1	23.0	183.6	117	118	1
Whitley	50.9	70.5	40.9	19.2	181.5	118	93	-25
Laurel	47.8	67.4	45.8	19.8	180.8	119	115	-4
Owsley	41.6	71.3	32.3	11.6	156.9	120	120	0

Source: Cabinet for Health and Family Services. Program Review staff reworded the column headings and rounded the percentages to tenths.

Appendix E

How Medicaid Savings From Noncustodial Parents Providing Medical Support Were Calculated

Kentucky could have saved $2.4 to $11.0 million in Medicaid costs in FY 2003.

Program Review staff estimated that Kentucky's Medicaid program could save $2.4 to $11.0 million a year if medical support orders were complied with as ordered. This appendix explains how the savings were calculated. Staff began by establishing an upper bound estimate to show that circumstances limit the actual potential of the state to reduce its expenses by this amount. Next, staff provided a fiscal estimate that considers various real-world limitations on the state's ability to reduce Medicaid costs.

Upper-bound Estimate of Medicaid Cost Savings

Theoretical cost-savings estimates will be overstated because not all medical support orders are complied with.

The theoretical upper-bound Medicaid cost savings was estimated. First, multiply the number of dependent children of noncustodial parents by the average Medicaid cost per child, and then multiply by Kentucky's share of Medicaid expenses—about 30 percent.[1]

Equation 1: $(D_y \times C_y) \times M_y = U_y$ where

D = number of dependent children whose noncustodial parent does not provide medical support despite an order to do so;

C = average annual Medicaid cost per child;

M = Medicaid cost-share for Kentucky (currently $0.30 for every $1 in Medicaid expenses)

U = upper-bound Medicaid cost-savings to Kentucky; and

y = year.

Assuming that every medical support order was complied with as ordered, Kentucky could have saved between $13.5 and $40.6 million in state Medicaid expenses during FY 2003. It is unlikely that all medical support orders would be followed, however. Incarceration, placement in a mental facility, unemployment, underemployment, geographic location, or the unavailability or

[1] It is unlikely that Medicaid costs for these dependent children exactly match the state average, but insufficient data are available to determine the actual Medicaid cost.

high cost of dependent health insurance are potential reasons that some medical support orders would not be complied with.

Reported Estimate of Medicaid Cost Savings

A more realistic estimate considers the effect of noncompliance with medical support orders and other factors.

To calculate a more pragmatic estimate of Medicaid cost savings for Kentucky, staff relied on the descriptive work of Laura Wheaton (2000) and data from the U.S. Department of Health and Human Services (Form 157). In Wheaton's report, data from the 1993 Survey of Income and Program Participation were analyzed. From this work, staff got a picture of national-level characteristics about noncustodial parents. These data were combined with Kentucky-specific information to arrive at a final estimate.

Program Review staff
1. compared the number of open medical support orders in Kentucky to the number of medical support orders that were complied with,
2. estimated how many noncustodial parents had access to dependent care health insurance,
3. estimated how many custodial parents had a family income at or below 200 percent of poverty,[2] and
4. estimated a likely range of state Medicaid costs.

Equation 2: $[(S_y \text{ x } I_y) \text{ x } N_y] \text{ x } C_y = E_y$ where

S = number of open medical support orders;

I = percentage of open child support cases with family income at or below 200 percent of the federal poverty threshold;

N = percentage of noncustodial fathers with access to health insurance for dependents;

C = average annual Medicaid cost per child;

E = estimate of annual Medicaid cost savings to Kentucky from noncustodial parents with access to and ability to pay for dependent health insurance for their Medicaid-eligible children actually doing so; and

y = year.

[2] Medicaid eligibility for children is 185 percent of the federal poverty level. KCHIP eligibility is 200 percent of the federal poverty level.

Only dependent children are considered who are eligible for Medicaid and fathers who have access to dependent health insurance.

This equation captures some of the constraints that the upper-bound estimate did not. In particular, only dependent children are considered who are eligible for Medicaid and noncustodial fathers who have access to dependent health insurance. By limiting the estimate to these two factors, a more accurate measurement is obtained of the potential cost-savings to Medicaid from noncustodial fathers providing health insurance to their Medicaid-eligible children.

Several assumptions, detailed below and in Table E.1, were necessary to arrive at the final estimate.

First, the equation assumed that all children living in custodial families with an income at or below 200 percent of poverty are using Medicaid services. That is, noncustodial fathers are assumed to not provide dependent health insurance coverage to any dependent child living in a family with an income at or below 200 percent of poverty. The effect of this assumption is to raise the estimate of cost savings.

Table E.1
Assumptions and Their Effects on the Estimate of Medicaid Cost Savings

	Assumption	Effect on Estimate of Cost Savings	
		Increase	Decrease
1	All dependent children in families with incomes equal to or less than 200% of federal poverty level use Medicaid services	•	
2	Noncustodial fathers are the only providers of health insurance for dependents		•
3	Health insurance for dependents is available at reasonable cost	•	
4	Average Kentucky cost savings are $250 to $750		
5	Dependent children would remain on Medicaid for full year	•	
6	Each open medical support case equals one dependent child.		•

Second, it was assumed that noncustodial fathers are the providers of medical support orders.[3] Noncustodial mothers, however, may also be required to provide medical support to their dependent children. Since child support primarily involves the mother as the custodial parent, staff did not consider noncustodial mothers. The effect on the overall estimate is to slightly understate the potential Medicaid cost savings.

[3] According to Laudan's (2002) analysis, 80 percent of all children living apart from one parent live with their biological mother.

Third, the equation assumed that because a noncustodial father has access to dependent health insurance, it is also available at a reasonable cost. In reality, this may not be the case. Dependent health insurance cost may far exceed an amount that the noncustodial father can be expected to pay. Information specific to reasonable cost is not available. Consequently, the effect of assuming that dependent health insurance access equates to reasonable cost is likely to raise the estimate of cost savings above what it would be really.

Fourth, the estimate predicted that the average Medicaid cost savings per child from the noncustodial parent providing health insurance would range from $250 to $750. The range is based on studies of seven state child support systems that were conducted by the U.S. Department for Health and Human Services Office of Inspector General between 2001 and 2004.[4]

Fifth, staff assumed that dependent children would remain on Medicaid for an entire year. Some dependent children, however, may become ineligible during the year due to higher family income, the dependent's age exceeding the Medicaid limit, or the noncustodial parent providing dependent health insurance. The effect of this assumption is to raise the estimate of cost savings.

Sixth, the estimate assumed that each open medical support case equals one dependent child. This assumption closely matches the overall child support caseload of 1.02 children per open case at the end of FY 2003. This assumption will have a minimal negative effect on the estimate of cost savings.

Bearing these assumptions in mind, staff calculated that Kentucky's Medicaid program could have realized state savings of $2.4 to $11.0 million in FY 2003. Total Medicaid savings—including the federal share—would have totaled $8.1 to $36.5 million for FY 2003.

---

[4] The reports examined child support programs in seven states to determine Medicaid cost savings that could be achieved if noncustodial parents with an ability to pay actually provided medical support to their Medicaid-eligible dependent children. The states studied were Connecticut, Indiana, New Jersey, New York, North Carolina, Texas, and Virginia.

Appendix F

Time Value of Money

Assuming that Kentucky is able to retain all cash and checks for one day longer, an additional $465,000 in annual interest income would be generated (assuming a 1 percent annual rate of return).

All else equal, the longer the state has to invest funds, the more interest income will be generated. Assuming that Kentucky would be able to retain all cash and checks for one day longer, an additional $465,000 in interest income per year would be generated (assuming a 1 percent annual rate of return).

Government's ability to maximize interest income is affected by several factors including the accuracy of disbursements, the completeness of collections, the length of float, and the amount of transaction costs. These factors have varying effects on the amount of money available for investment. The factors are shown in Table F.1 and are described below.

Table F.1
Effect of Disbursements, Collections, Float, and Transaction Costs on Amounts Invested

	Effect on Amount To Be Invested	
	Increase	**Decrease**
Disbursements		
Overpayments		•
Underpayments	•	
Collections		
Over-deposits	•	
Under-deposits		•
Float	•	•
Transaction Costs		•

Disbursements

- An "overpayment" is an excess payment to another entity or individual. Because more funds than necessary are paid, the overpayment reduces the amount of funds available for investment. Overpayments have a negative effect on interest income.

- An "underpayment" is a payment for less than the actual amount due. Until the underpayment is discovered and

corrected, it increases the amount of money available for investment.

Collections

- An "over-deposit" is a payment to state government that was larger than it should have been. It increases the amount of funds available to state government. For example, when a corporation incorrectly pays more income taxes than required, the state has more funds to invest. Until the error is discovered and corrected, the state will have a larger investment fund balance and, subsequently, higher interest income.

- When the state receives fewer funds than it is due, this represents an "under-deposit," or underpayment to state government. Under-deposits include nonpayments and partial payments (uncollected revenue). The state has less money to invest and earns less interest income.

Float

Float affects state government finances because it can delay or accelerate the disbursement and collection of funds.

Float is the time between when a payment or deposit is made and when it clears a financial institution. Float affects state government finances because it can delay or accelerate the disbursement and collection of funds, which in turn can affect the amount of interest income the state earns.

It is generally to the state's advantage to maximize the time it takes to make a payment and minimize the time it takes to collect a payment. Both can increase the amount of interest income.

Transaction Costs

Transaction costs reduce the amount of money available for investment.

Transaction costs, which are unavoidable, reduce the amount of money available for investment. Cash and electronic transactions each have transaction costs. They can include staff and administrative time to process, review, and mail a payment; staff time to collect and deposit a payment; courier service to transport the money to a financial institution for deposit; or credit card processing fees assessed by the credit card companies for each credit card transaction.

State Government Payments

In FY 2003, state government made slightly more than 10 million payments.

In FY 2003, state government made slightly more than 10 million payments. These included 7.5 million checks, 2.5 million automatic clearinghouse transactions, and about 5,100 wire transfers. Automatic clearinghouse transactions include direct deposit; automatic bill payment; deposit of tax refunds; business-to-business payments; and e-checks (Commonwealth, Kentucky State Treasury). (See Table F.2 below.)

Table F.2
Kentucky State Government Payments by Transaction Type, FY 2003

	Checks	Automatic Clearinghouse	Wires	Total
Number	7,530,396	2,486,981	5,146	10,022,523
% of Total	75.1	24.8	0.1	100.0
$ Amount	$9,307,755,924	$5,319,359,755	$50,567,766,030	$65,194,881,708
% of Total	14.3	8.2	77.6	100.0

Note: Categories may not add to exact totals shown due to rounding.
Source: Kentucky Treasurer's Office.

Despite the high volume of checks, the overall dollar value of those transactions was small. Just 14 percent, or $9.3 billion, of all government payments were checks in FY 2003. Automatic clearinghouse transactions totaled $5.3 billion and accounted for 8 percent of all government payments. Wire transfers represented the bulk of government payments. Approximately $50.6 billion, or 78 percent, of all government payments in FY 2003 were wire transfers. These transfers typically involved retirement and other similar funds.

State Government Receipts

Most state receipts come from electronic transactions.

By dollar value, most payments to state government were received electronically. As shown in Table F.3, less than 12 percent of receipts consisted of cash or checks.[1]

[1] Cash (noncheck) receipts equaled about $2.5 billion of the $7.7 billion total. Most cash receipts apparently come from state auctions, confiscated drug money, and cafeterias (Commonwealth, Kentucky State Treasury).

Table F.3
Payments to State Government by Transaction Type, FY 2003

	Cash and Checks	Electronic	Total
$ Amount	$7,691,379,428	$57,081,260,996	$64,772,640,424
% of Total	11.9	88.1	100.0

Source: Compiled by Program Review Staff from information obtained from the Kentucky State Treasurer's Office.

Electronic and Paper Transactions

Cash and check transactions outnumber other forms. Table F.2 showed that checks made up about 75 percent of all payments made by the state in FY 2003. Nationally, check usage has grown by 30 percent, from 32.8 billion checks written in 1979 to 42.6 billion in 2000 (Federal Reserve Bank).

Eighty percent of all local checks (defined as within a limited geographic area) are presented for payment within one business day. About one-half of all nonlocal checks are presented for payment within one business day.

According to a study by the Federal Reserve Bank of Richmond, 80 percent of all local checks are presented for payment within one business day. About one-half of all nonlocal checks are presented for payment within one business day. Up to 12 percent of all nonlocal checks are presented for payment in more than two days (Lacker). Electronic payments typically clear within one business day.

Electronic receipts reduce the risk that checks will be returned as unpayable.[2] Because of the lag time between when a check is written to the state and when it is deposited in the state's bank account, the state is not only increasing the length of float, but it is also taking the risk that insufficient funds will be available in the payer's checking account. Electronic receipts, particularly credit and debit cards, eliminate the risk that payment will not be made.

Interchange fees assessed by the credit card companies raise the cost of accepting credit card payments. The cost can be recouped through convenience fees.

Electronic transactions also have costs. Interchange fees assessed by the credit card companies raise the cost of accepting credit card payments. These fees are charged for each credit and debit card transaction. They typically range from 1 to 3 percent of the transaction total. Unless the interchange fees are recouped through higher costs to the payer (for example, through convenience fees), interchange fees directly reduce the amount of revenue available to the state.

[2] According to a 2001 study sponsored by the Federal Reserve System, 0.6 percent of all checks nationwide were returned to the payer's bank.

Reducing Float Can Increase Interest Income for Kentucky

Changing float in the state's favor can result in additional interest income.

With check disbursements of $9.3 billion and check and cash deposits of $7.7 billion in FY 2003, even small increases in float can mean significant revenue loss for the Commonwealth. Changing float in the state's favor by even one day can make additional funds available for investment and can increase interest income.

Assuming that the float on all disbursements and collections was reduced by one day, perhaps through electronic transactions, more than $465,000 in additional interest income would be generated (assuming a 1 percent annual rate of return).[3] Interest income would naturally rise with the annual rate of return.[4] Table F.4 illustrates the potential for increased interest income by reducing float. Interchange fees would reduce the net amount of additional interest income. Convenience fees could be used to offset this cost.

Table F.4
Additional Annual Interest Income Generated From Investing Specified Funds One Day Sooner at a Given Annual Interest Rate

% of Total Cash & Checks in FY 2003	Daily Amount Invested	Total Annual Amount Invested (Daily X 365)	Annual Interest Rate		
			1.0%	1.5%	2.0%
1	$465,730	$169,991,354	$4,657	$6,986	$9,315
5	$2,328,649	$849,956,768	$23,286	$34,930	$46,573
10	$4,657,297	$1,699,913,535	$46,573	$69,859	$93,146
20	$9,314,595	$3,399,827,070	$93,146	$139,719	$186,292
30	$13,971,892	$5,099,740,606	$139,719	$209,578	$279,438
40	$18,629,189	$6,799,654,141	$186,292	$279,438	$372,584
50	$23,286,487	$8,499,567,676	$232,865	$349,297	$465,730
60	$27,943,784	$10,199,481,211	$279,438	$419,157	$558,876
70	$32,601,081	$11,899,394,746	$326,011	$489,016	$652,022
80	$37,258,379	$13,599,308,282	$372,584	$558,876	$745,168
90	$41,915,676	$15,299,221,817	$419,157	$628,735	$838,314
100	$46,572,974	$16,999,135,352	$465,730	$698,595	$931,459

Kentucky has begun to use electronic transactions. Several state agencies and boards have successfully implemented the ability to accept electronic payments. This transaction process is called "ePay."

[3] This figure includes both tax and nontax receipts.
[4] Higher rates of return generally reflect increased risk.

ePay

All state agencies and the courts are able to use ePay, but few actually do.

The Commonwealth established ePay in the late 1990s when the Division of Fish and Wildlife expressed an interest in allowing people to purchase hunting and fishing licenses with credit and debit cards. The system is now available to all state government agencies and the courts.

Figure F.A illustrates the ePay process. An ePay transaction begins when a customer either goes to an agency or navigates to an agency's Web site, paying for the good or service with a credit or debit card.

A credit card transaction goes through ePay and then to Link2Gov, the state's authorized processor of electronic transactions. Link2Gov then processes the transaction request and receives an approval or denial notice directly from the credit card company (VISA, MasterCard, American Express, or Discover). Link2Gov then transmits the approval or denial information back to the agency. The customer and state agency know in real time whether the transaction was completed.

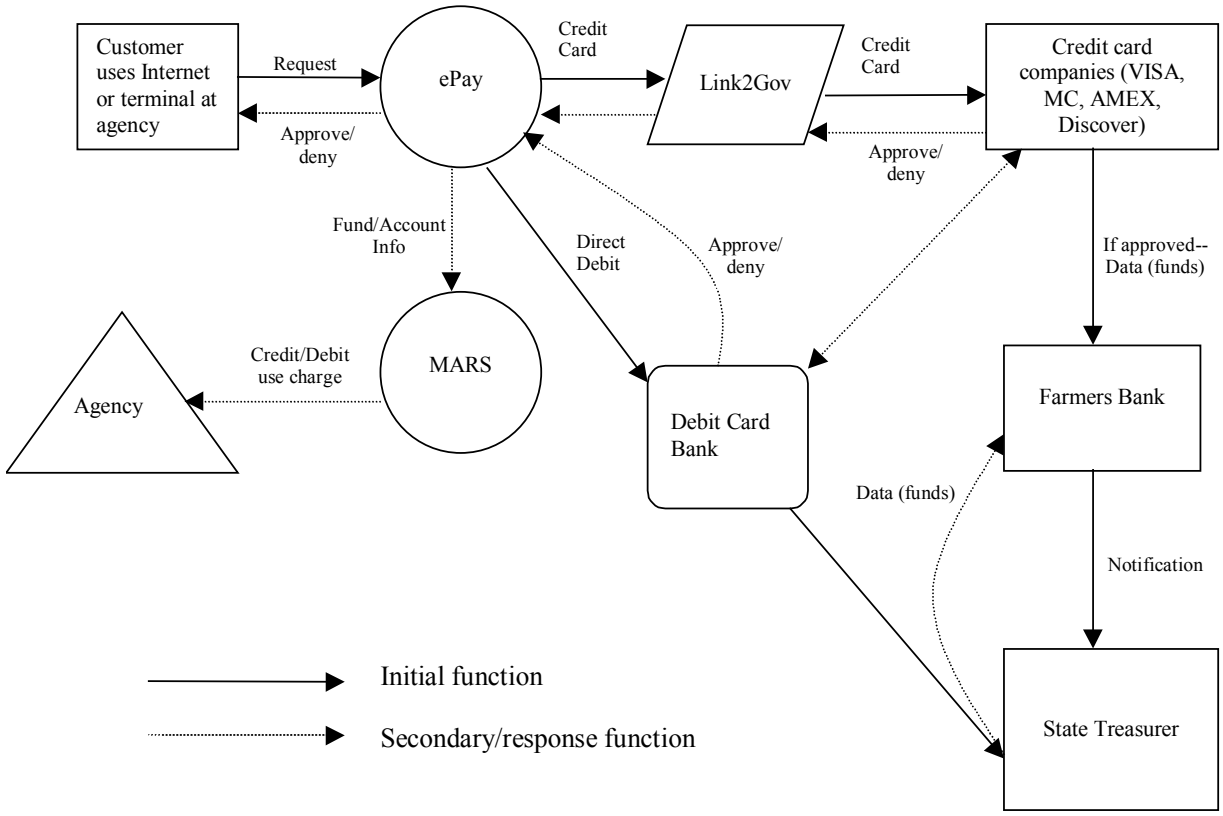
Credit and debit card receipts are transmitted electronically to the state's bank account. Float is thus changed in the state's favor.

Assuming that the transaction was successful, the funds from the credit card purchase are transmitted to Farmers Bank, the state's primary bank. The bank then notifies the State Treasurer that these funds are available. At the same time, Link2Gov transmits information to ePay about where the transaction originated. ePay in turn transmits this information to the Management Administrative and Reporting System (MARS), the state's electronic accounting and management system. MARS records the receipt.

Debit card transactions get routed to the debit cardholder's bank for approval and then, if approved, are sent to the state's bank. Information about the transaction is sent through ePay to both the customer and MARS.

One additional step completes all electronic transactions. Credit card and debit card interchange fees are assessed on the agency or court that originated the electronic transaction. Any convenience fee that the agency or court charges would partially or fully offset the interchange fee.

Figure F.A
ePay Process Flowchart for Credit and Debit Cards



Source: Compiled by Program Review staff from information provided by the Finance and Administration Cabinet, Division of Statewide Accounting, during a meeting on April 1, 2004.

As of March 31, 2004, ePay was used by 23 state government agencies, as shown in Table F.5. For the May 2003 through March 2004 period, these state agencies had $4.9 million in authorized credit card receipts. The median authorized receipt for all state agencies was $79.62 during this period.

Table F.5
State Agencies Using ePay and Average Authorized Charges
(as of March 31, 2004)

Agency	Average Charge
Arts Council	$141
Commonwealth Office of Technology-Geographic Information	$186
Controller	$1
Correctional Industries	$507
Department of Education Bookstore	$48
Office of Financial Institutions	$143
Division of Fish and Wildlife	$53
Historical Society	$43
Department of Housing	$219
Department of Insurance	$26
Kentucky Fair Board	$84
Kentucky Virtual University	$32
Libraries and Archives	$31
Board of Nursing - License Renewal	$104
Board of Nursing -License Verification	$1
Division of Occupations and Professions	$80
Department of Parks-Central Office	$149
Real Estate Commission	$1,021
Department of Revenue	$385
Secretary of State	$10
Department of Transportation-Central Office	$52
Department of Transportation-Driver's History	$12
Department of Transportation-Vehicle Information System	$141

Note: The list is composed of state agencies using ePay as of March 31, 2004.
Average charges are for May 2003 to May 2004.
Source: Compiled by Program Review staff from information obtained from <www.kentucky.gov> (list of agencies) and Finance and Administration Cabinet, Office of Statewide Accounting (amounts).

Outside governmental and quasi-governmental agencies and the courts have access to ePay. Officials with the Division of Statewide Accounting, the agency responsible for overseeing ePay, stated that they are focusing more attention on maintaining system integrity than on expanding the number of external users.

Within the Division of Occupations and Professions, several boards have implemented electronic transaction capability. The boards have established a standard of electronic service delivery that other state agencies and boards can follow.

Overall, 15 state boards located within the Division of Occupations and Professions offer electronic payment services, as shown in Table F.6. With electronic receipts, several benefits accrue to the boards and the clients. The benefits include 24-hour renewal capability, greater certainty of receipt by the board, and an increased potential for higher interest income due to a reduction in the time it takes for payments to be deposited to the state's bank account.

Table F.6
Division of Occupations and Professions' Boards
With On-line License Renewal
(as of March 31, 2004)

Board of Certification for Alcohol and Drug Counselors
Board of Certification for Professional Art Therapists
Directory of Registered Athlete Agents
Board of Licensed Professional Counselors
Board of Dieticians and Nutritionists
Fee-Based Pastoral Counselors Board
Board of Registration for Professional Geologists
Interpreters for the Deaf and Hard of Hearing Board
Board of Licensure for Marriage and Family Therapy
Board of Licensure for Nursing Home Administrators
Board of Ophthalmic Dispensers
Board of Examiners of Psychology
Board of Social Work
Board of Speech-Language Pathology and Audiology
Board of Veterinary Examiners

Source: Finance and Administration Cabinet, Division of Occupations and Professions.

Appendix G

Response From the Administrative Office of the Courts

ADMINISTRATIVE OFFICE OF THE COURTS
100 MILLCREEK PARK

FRANKFORT, KENTUCKY 40601-9230
p 502-573-2350 or 800-928-2350
www.kycourts.net

JOSEPH E. LAMBERT
CHIEF JUSTICE

MELINDA L. WHEELER
DIRECTOR

November 17, 2004

Greg Hager, Ph.D.
Program Review & Investigations Committee Legislative Research Commission
Capitol Annex - Room 9
Frankfort, KY 40601

Dear Dr. Hager:

The Court of Justice welcomes this opportunity to clarify its role in the collection of fines, fees and costs assessed against individuals convicted of crimes and other violations in Kentucky. Prescribed by statutes, these fines, fees and costs are imposed by circuit and district court judges and paid to the Commonwealth through circuit court clerks' offices located in every county in the state. As noted in the Program Review and Investigations Committee's staff report, circuit court clerks collected and remitted approximately $65.2 million to the Commonwealth in fiscal year 2003.

Given the legal and practical constraints under which they must operate, Kentucky's trial court judges and clerks administer the fiscal aspects of criminal justice in the Commonwealth with remarkable efficiency. It is a reality that some individuals who are convicted of crimes or violations simply do not have the means to pay the associated fines, fees or costs. Judges presently lack authority to order defendants to perform community service *in lieu of* paying fines, fees or costs, although many can and do require such service *in addition to* imposing payment obligations. While judges may waive fines or fees in a given case, they are required by law to assess costs against a defendant unless he/she meets the statutory definition of a "poor person."

Once a defendant has been adjudged guilty of a crime or violation and ordered to pay fines, fees and/or costs, payment is typically required immediately. Depending upon the defendant's financial circumstances, a judge may allow him/her additional time to pay. In this event, the judge directs the clerk to establish another court date and the defendant is ordered either to make full payment by that date or appear again before the judge to explain his/her delinquency. Defendants who reappear but cannot show good cause for their failure to pay may be ordered to serve time in jail.

In those cases where a defendant fails to reappear, the judge's only recourse is to issue a bench warrant for his/her arrest. The clerk then delivers the warrant to a sheriff or other law enforcement agent for service upon the defendant. At that point, the judge and clerk have done everything in their power to enforce collection of the defendant's debt to the Commonwealth. Neither judges nor clerks have the power of arrest.

It is important to remember that Kentucky's constitution divides the various powers of government among distinct legislative, judicial and executive branches. It also expressly prohibits one branch from exercising powers properly belonging to the others. (See Constitution of Kentucky, Sections 27 and 28). This separation of powers is fundamental to the Commonwealth's tri-partite system of government and has historically been strictly construed.

In the criminal justice context, this means that subject to certain checks and balances, the legislative branch is empowered to proscribe what conduct is unlawful, the judicial branch is empowered to adjudicate the guilt or innocence of those charged with crimes or violations and the executive branch is empowered to enforce any punishment meted out. Thus, while the imposition of criminal fines, fees and costs is the responsibility of judges, the execution of legal process and enforcement of court orders is the exclusive province of executive branch employees. To the extent the staff report implies that collection of criminal fines, fees and costs has not been a priority for the Court of Justice - or more specifically for its administrative and fiscal agency, the Administrative Office of the Courts (AOC) - it embodies a basic misunderstanding of the judicial branch's proper role in the governmental structure of the Commonwealth. The essential function of the judicial branch is and always has been the adjudication of individual cases. It falls to the executive branch to enforce judgments and orders rendered by the courts.

The staff report nevertheless includes a number of recommendations that the AOC is incorporating into its strategic planning in order to assist the executive branch in its goal of maximizing the amount of criminal fines, fees and costs collected for the benefit of the Commonwealth. For example, an automated system for tracking new assessments of fees, fines and costs and payments made by defendants in criminal cases is now being piloted in Owen County. Similarly, a pilot project to determine the feasibility of collecting unpaid fees, fines and costs already assessed against defendants in criminal cases has begun in Anderson County. A pilot project to enable defendants to pay fees, fines and costs via credit cards has been successfully tested in Warren County and expanded to Calloway, Marshall, McCracken and Pulaski Counties.

Moreover, consistent with the mandates of HB 162 and SB 228, enacted by the 2004 General Assembly, the AOC is now working with the Finance and Administration Cabinet to establish a system for identifying "liquidated debts" - criminal fines, fees and costs still unpaid after expiration of time for payment allowed to defendants by statutes - so that they can be referred for possible collection by the Revenue Department. The AOC expects to continue providing input to Finance and Administration Cabinet officials as they develop criteria for assessing the feasibility of pursuing collection of such referred debts as well as implementation of systems to withhold them from state disbursements otherwise due defendants.

Yours truly,

Melinda L. Wheeler
Director

Appendix H

Response From the Cabinet for Health and Family Services

The response from the Cabinet for Health and Family Services refers to specific quoted material from an earlier draft of this report. In some instances, the wording is different in the final version of the report.

ERNIE FLETCHER
GOVERNOR

Cabinet For Health and Family Services
OFFICE OF THE SECRETARY
275 EAST MAIN STREET, 5W-A
FRANKFORT, KENTUCKY 40621-0001
(502) 564-7042 (502) 564-7091 FAX
WWW.KENTUCKY.GOV

JAMES W. HOLSINGER, JR., M.D.
SECRETARY

October 4, 2004

Greg Hager, Ph.D.
Program Review and Investigations Staff
Room 300
State Capitol Annex
Frankfort, KY 40601

Dear Dr. Hager,

This letter is in response to your August 3, 2004, Program Review and Investigations Committee Staff report entitled "Uncollected Revenues and Improper Payments Cost Kentucky Millions of Dollars a Year". The Cabinet is concerned that there are many factually accurate details included in the report that are taken out of context, which may be misleading to the public audience. The following comments and are meant to clarify those details:

PAGE 27, PARAGRAPH 1
"Medicaid is at high risk for making improper payments…"

Medicaid is vulnerable to the types of improper payments identified, but using "high risk" to characterize the level of vulnerability is misleading as it implies the magnitude of the improper payments is significant. The report offers no evidence of this and in fact provides evidence on later pages that the magnitude is relatively minor. The CORE program completed more than 3,400 investigations and identified only $6.6 million in improper payments over six years. During this same six-year period, Medicaid benefit expenditures were over $19.5 billion, so the identified improper payments were less than one tenth of 1%.

PAGE 27, PARAGRAPH 2

"Medicaid is also at high risk for failing to collect debts."

Medicaid is vulnerable to incurring bad debts, but using "high risk" to characterize the level of vulnerability is misleading as it implies the magnitude of the bad debts is significant. The report offers no evidence that this is so and in fact provides evidence on later pages that the magnitude is also relatively minor. As Medicaid benefits expenditures have risen from $2.6 billion in 1998 to $3.8 billion in 2002, the amount recovered from third parties has remained at approximately the same $3 million level, which is a declining percent from 0.12% to 0.08%. This despite the fact that such recoveries are contracted out on a contingency basis that means the contractor has a significant incentive to identify and collect such monies. As previously explained the amount of improper payments for which there is no third party from which to recover is relatively minor, and recoveries from recipients will be less than $20,000 in SFY04.

PAGE 27, PARAGRAPH 3

"Medicaid reported $95 million in noncurrent accounts receivable, which are debts that are not expected to be collected in the near term. Medicaid's debt equaled 96 percent of statewide noncurrent receivables."

The report doesn't identify the source of the accounts receivables nor the time period(s) covered by these receivables but instead inaccurately characterizes them as improper payments made during the current period.

Identifying the source of these receivables and the period covered would produce a more accurate picture of Medicaid's accounts receivables and the problems involved in collections. Also, identifying the account receivables compared to the total Medicaid budget would present a clearer picture. Medicaid's current annual expenditure is $4 billion dollars. If the entire $95 million accounts receivable were from one year, this equals only 2% of the Department's expenditures, which means 98% of the Department's accounts receivable were correctly collected. If compared to the actual periods when the expenditures were made, the comparison would probably be less than 1% in error.

The $95 million characterized as "noncurrent accounts receivable" represents both $75 million of debt likely to be collected, most in SFY05, and $20 million of bad debts covering multiple years which is unlikely to be collected and would be written off in a non-governmental business entity. Because of federal Center for Medicare and Medicaid Services' (CMS) requirements, the $20 million remains on Medicaid's books but to represent it as a source of revenue to Medicaid if collection efforts were enhanced is misleading. The collectible portion of the accounts receivable includes (1) cost settlements with hospitals that now owe Medicaid any monies they received in excess of their subsequently reported costs, and (2) drug rebates invoiced but not yet received by Medicaid.

The first item included in the accounts receivable is derived from cost settlements, which were generated by a payment methodology that established a future rate based on past cost and then required a settlement to actual cost after the close of the fiscal year. Any provider who had been paid more than actual cost would then owe the Commonwealth. This payment methodology has been changed for many providers eliminating the related receivables. Hospitals have gone to Diagnosis Related Groups (DRG)'s, Nursing Facilities going to price, etc.

The second item included in the $95 million dollars of accounts receivable is drug rebate monies. These rebates have been invoiced but have not yet been received by Medicaid.

PAGE 27, PARAGRAPH 4

The inference of this paragraph is that implementing these measures will result in benefits that significantly outweigh the costs. While each recommendation has merit as a Quality Assurance mechanism, assuming that there is a significant financial benefit is not substantiated.

Page 28, Paragraph 1

"Medicaid spends about $1.2 billion in state general funds each year."

This statement is incorrect. Medicaid does spend about $1.2 billion in state funds but not all of this funding is General Funds. The actual breakdown for SFY 2004 was $761.7 million in General Funds and $401.2 million in Agency or Restricted Funds.

PAGE 28, PARAGRAPH 3

"Pharmacy costs alone have increased almost 350 percent from 1992 to 2003, more than 10 times the overall inflation rate."

The implication is that the rapid rise in state spending is related to improper payments, when no evidence is provided to support such a contention. There are easily identified cost drivers in Medicaid that are not related to improper payments (pharmacy price inflation, recipient population increases, new or expanded programs, etc.). Collection of debts has no relevance to costs and is included inappropriately. This statement would be more meaningful in context if it compared the increase in pharmacy cost for Medicaid to the pharmacy cost for other payers and not to the general inflation rate.

PAGE 28, PARAGRAPH 4

"The Medicaid program has an incentive to prevent overpayments to providers."

The word "incentive" is used in its extended meaning as "motivation" but as used here implies a financial reward in excess of the face value of the claim amount. However, the reality is that preventing overpayments to providers does not always yield a gain to the

Department. Some of the "overpayments" are simply coding errors and correcting the "error" only generates a recoupment and another payment. A better characterization might be to say that the Department has a "financial interest in preventing overpayments."

Although the description of the process for the federal government to recover their funds relating to accounts receivable is correct. The reference in the report to that recovery process inaccurately implies that the process is simple and can be completed quickly. The federal government requires that its funds be returned within sixty days of identification of the receivable. It does not take into account the reason for non-collection (provider filed bankruptcy, provider died, provider no longer in practice, etc.). The state must research and determine why the receivable was not collected, which may require some time. If all avenues for collections have been exhausted to CMS's satisfaction, only then can the state write off the receivable and reclaim the federal share. The Cabinet agrees it has not pursued this option aggressively in the past. However, it must also be clarified that CMS does not have a clear policy for what "all avenues for collections" involves. The Cabinet is working with the CMS regional representatives to identify the process(s) that need to be completed to either collect the receivables or to write them off and reclaim the federal share.

PAGE 29, PARAGRAPH 3

As indicated by the report's later data, "cost avoidance" is a significantly greater factor ($190 million in SFY02) than recovery ($3.2 million in SFY02) from third parties. Cost avoidance has increased from $62 million in SFY98 to $191 million in SFY02, while recoveries from third parties has remained at about $3 million annually. Clearly the focus has been on cost avoidance, not "pay and chase". As the report states on Page 30, "In FY 2002, Medicaid saved almost sixty times more through preventing improper payments than it collected in overpayments."

PAGE 29, PARAGRAPH 4

"*Collections are inversely related to preventing improper payments. Preventing more improper payments decreases collection totals but represents additional value to the state because it pays less in administrative expenses. In addition, the state keeps its money in the bank, which; increases interest income or the funds available for other purposes***"**

The Medicaid program in Kentucky had the second lowest administrative cost in the nation based on CMS data. Kentucky in fact is probably the lowest since the data from Michigan showed they had negative administrative expenses for the year due to adjustments made. A major part of the problem for the program's inability to collect accounts receivable is the lack of staffing. Increased staffing to work on collecting the current receivables and more closely monitoring future payments will increase administrative cost and could cost the state more than the payments. Every dollar spent on administration cost the state fifty cents however every dollar spent on services only cost the state thirty cents. The Medicaid program is not recommending that expenditures

not be monitored and improper payments made but do not feel this will equal "additional value to the state because it will pay less in administrative expenses."

PAGE 30, PARAGRAPH 2

Total TPL cost avoidance, federal and state dollars, based on numbers reported directly from the MMIS, has increased from approximately $527 million in FYE 2001 to $749.4 million for FYE 2004. At the same time, total TPL recoveries, state and federal, increased to $23.3 million in FYE 2003, and are currently tracking to nearly $40 million for FYE 2004. Data confirming the FYE 2004 numbers will be available very soon. While it is absolutely correct that cost avoidance numbers and recovery numbers are inversely proportional, and that the ultimate goal is to continue to enhance cost avoidance as the most costs effective manner to enhance TPL, the fact that both number sets have increased so dramatically at the same time is a reflection of intense focus on TPL in the last few years and the numerous programs implemented. Ultimately, the recovery numbers will begin to level off or drop as cost avoidance continues to grow.

PAGE 31, PARAGRAPH 2

"Kentucky's statute relevant to data matching (KRS 205.623) is insufficient to ensure that Medicaid is able to maximize its ability to discover third-party coverage through electronic data matches with the eligibility files of all insurers…the statue provides no penalty for not complying with the Cabinet's request."

Since there is not a penalty, there is no reason for any third party to assist the Medicaid program in identifying any cost that they would then have to pay. Without help from the General Assembly in adding a penalty the Medicaid program will only spend more on administrative cost with no benefit.

PAGE 31, PARAGRAPH 3

This legislation was drafted by the Cabinet and proposed for sponsorship in the 2004 Session, but was not filed for consideration. At the same time, Medicaid has significantly increased its efforts in requesting eligibility files from individual carriers and in the last year cooperation and response from the carriers is much improved. Plus, Medicaid's TPL contractor, Public Consulting Group, has extensive data matching contacts in the industry and we have taken advantage of this opportunity. These efforts have played a large part in the enhanced cost avoidance numbers over the last few years. Legislation, as recommended, would still be welcomed as a means to further enhance efforts.

PAGE 32, PARAGRAPH 6

To clarify, estate recovery collections have existed since 1994. The function was performed under an agreement with the Medicaid eligibility contractor, Department for Community Based Services (DCBS), until FYE 2002, when the DCBS notified Medicaid that it would not renew the agreement for FYE 2003. This proved to be a blessing in

disguise, as the function reverted in house to Medicaid's Division of Program Integrity, and collections have been enhanced to more than $1 million state share dollars for FYE 2004 while increasing efficiency and devoting fewer overall resources to the function.

PAGE 34, PARAGRAPH 1

Deactivation of edits and audits, in the system, does not always reflect a problem from the standpoint of identifying and preventing erroneous or fraudulent claims. An edit has to be defined in the system to apply consistently to all claims (both legitimate and fraudulent). Therefore, the Department must balance whether to edit all the claims, and force those that could be legitimate to submit records proving it before they get paid, which is a burden on these providers and often yields poor relations; or, you allow them all to go through and conduct post payment review, like we do in Program Integrity (now in OIG) and recover from the ones that could not justify through the medical records. When an edit is deactivated, it could be for legitimate reasons, not that we are ignoring fraud and abuse, but have determined that the burden on the legitimate provider bills is too great, and we will resort to post payment review to catch the bad ones

PAGE 34, PARAGRAPH 6

"The Cooperative Review of Eligibility (CORE) investigative program, operated by the CHFS Office of the Inspector General, was discontinued in the first quarter of FY 2003."

The former Cabinet for Families and Children, Department for Community Based Services discontinued the program by terminating the program's funding.

PAGE 35, PARAGRAPH 2

"He estimated that these investigations identified $6.6 million in improper payments in public benefit programs, including both state and federal funding. Most of the improper payments were identified quickly enough to be prevented."

The goal of CORE is to stop the public benefit payment prior to it being issued to an ineligible recipient. CORE investigations prevented $6.6 million in public benefits being issued to ineligible recipients. The OIG completed CORE investigations and provided investigative findings to the DCBS within 15 days to ensure that ineligible recipients did not receive public assistance benefits.

PAGE 35, PARAGRAPH 3

"…the cabinet should consider reviving CORE or a similar program, depending on the results of a cost-benefit analysis. Even if the program is revenue neutral..."

A cost-benefit analysis for the CORE program was completed for each State Fiscal Year (SFY) from 1997 through 2002 and was contained in the SFY reports submitted to the former Cabinet for Families and Children, Department for Community Based Services.

These cost-benefit analyses have all determined that the CORE program is much more than revenue neutral with an estimated $4 to $5 in program savings for each dollar spent on the CORE program.

PAGE 36, PARAGRAPH 2

In addition to the tasks already listed, the Division of Special Investigations is expected to perform the following:

- Conduct investigations of potential fraud in public assistance through desk reviews using various databases and correspondence to develop cases;
- Investigate allegations of employee malfeasance;
- Make referrals to CHFS agencies for administrative recoupment;
- Operate the statutorily required Medicaid & Welfare Fraud Hotline and disseminate hotline;
- information to all parties, necessary, regulatory and otherwise;
- Serve as the law enforcement liaison for the Cabinet and make criminal referrals; and,
- Conduct investigations related to the Cabinet and its programs.

PAGE 37, PARAGRAPH 1

"The Inspector General should develop a method to report the results of audits and investigations."

The Office of Inspector General currently has a method in place regarding investigative and audit results.

PAGE 38, PARAGRAPH 2

The LRC report indicated that receivables in the Drug Rebate program will not be collected in the "near future". However, monthly collections for SFY04 averaged over $12 million each month. For the first fifteen (15) days of July SFY05, the collections were over $20 million. The amount of truly "noncurrent" drug rebate receivables is $28 million dollars dating back to 1991, when the drug rebate program began. However, in contrast, the expected annual volume for SFY04 alone is in excess of $140 million.

PAGE 40, PARAGRAPH 1

The Department has programmed the payment system to begin calculating interest on aged balances; however, this is a very complicated formula. With the procurement of a Pharmacy Benefits Manager (PBM) to manage the pharmacy payment system, including all functions of drug rebate, the decision to implement interest assessment was put on hold so that the PBM can bring their expertise to bear on the formula and calculation.

PAGE 39 – PAGE 43, PARAGRAPH 3

The Cabinet, historically, did not devote sufficient internal staff and resources to resolving disputed/aged rebate balances. Through the efforts of limited staff, and the previous contractor devoted to this function, the aged balance has been reduced, but this reduction has resulted in few, if any, actual collections. Work on the aged balances has revealed that these amounts are a reflection of previously overstated and erroneous pharmacy provider billing, and incorrect data from CMS. Thus, there was little, if any, interest to assess. In addition, the resolution of an aged balance can and does often result in the Cabinet owing the manufacturer, as the manufacturer may have previously paid part of the balance and now it appears the manufacturer payment was more then than to total owed. Interest can be assessed by the manufacturer on the Cabinet in these situations and until the aged backlog is cleaned up, opening the door to interest assessments could expose the Cabinet to an unanticipated financial burden. Also, the effort to go backward in time, as far as 1991, to discover the faulty data that led to the manufacturer disputing the amount, is quite labor intensive and time consuming. The Cabinet is devoting all available resources to this effort. Once the pharmacy benefits manager (PBM) is on board, all future invoicing and collections will be handled with adequate resources and expertise, and interest will be assessed on future collections, if applicable. It is always important to place a Medicaid receivable of any sort in context to the overall size of the program. For drug rebates, there has been nearly $1 billion actually collected through the normal invoicing and collection process, since the program began in 1991. For there to be less than $30 million in backlog over the same period, most of which we believe to be overstated and not actually collectible dollars, is not indicative of a faulty overall program. It is indicative of previously insufficient resources and skill devoted to this program to avoid these problems. The Cabinet and this Administration is committed to devoting the necessary resources to clean up the backlog and avoid these issues in the future. In that vein, we agree with the recommendations 3.4, 3.5 and 3.6 and are presently engaged in this work.

PAGE 43, PARAGRAPH 4

"Other OIG activities include administrative pursuit of recoveries and referral to prosecuting authorities of possible criminal violations."

Previously, if a determination is made by OIG that administrative action, rather than criminal prosecution, is necessary then the investigation was referred to the DMS for collection. With the reorganization, OIG-Special Investigations refers these types of cases to the OIG-Division of Fraud, Waste & Abuse/Identification and Prevention for collection.

PAGE 43, PARAGRAPH 5

"Kentucky's Attorney General began conducting welfare fraud criminal investigations in 1980. The Special Investigations Division receives referrals for investigation from CHFS."

The OIG referred cases for investigation when the Office of the Attorney General (OAG) -Special Investigations Division began criminal investigations in 1980. The investigations that the OIG refers to the OAG for possible prosecution are cases that have been worked to completion by OIG. The OIG investigations include evidence supporting the alleged fraud allegation, fixed overpayments and often times, written statements from the perpetrator. Once the OAG receives the investigation from the OIG, the OAG may only need to interview the perpetrator prior to starting the court process for a criminal conviction.

PAGE 44, PARAGRAPH 2

"The investigators establish a case and forward it to prosecutors."

As noted above, this statement implies that the OAG conducts the entire investigation. In fact, the OAG receives a completed investigation by the OIG. Thus, when the OAG receives the case, the matter normally requires only an interview of the perpetrator and the filing of a criminal complaint. The related court proceedings are then handled in the normal course by local prosecutors.

PAGE 45, PARAGRAPH 1

"Investigations in 2002 and 2003 included 14 cases involving DCBS caseworkers."

These cases were initially referred by the OIG to the OAG and the majority of the time were investigated completely by the OIG prior to case referral for possible prosecution.

PAGE 45, PARAGRAPH 3

"The Attorney General's Medicaid Fraud and Abuse Control Division is responsible for conducting investigations of Medicaid providers…"

The Attorney General's Medicaid Fraud and Abuse Control Division is responsible for conducting criminal investigations. The OIG conducts Medicaid preliminary investigations and then refers to the OAG and other agencies, as appropriate.

PAGE 45, PARAGRAPH 5

The report does not adequately delineate the role of the OIG in the investigation of Medicaid provider fraud and abuse, nor does it adequately describe the interactions with the OAG Medicaid Fraud Control Unit.

The report also fails to reflect an understanding of the significance of the Medicaid/Welfare Fraud and Abuse Hotline in combating both recipient and provider fraud and abuse in the Cabinet's public assistance programs.

PAGE 46, PARAGRAPH 2
"Kentucky's MFCU receives referrals for investigations…"

Kentucky's Medicaid Fraud Control Unit (MFCU) also receives completed OIG Medicaid preliminary investigations that appear criminal.

PAGE 46, PARAGRAPH 3
"OIG referrals generally consist of complaints of third-party liability, recipient ineligibility, and recipient fraud, which are outside of MFCU's jurisdiction. Therefore, most referrals from OIG cannot be handled by the MFCU."

Although most OIG hotline referrals reviewed by the MFCU are recipient related, the OIG regularly sends the MFCU provider related cases due to information learned from the hotline, other sources, and as a result of Medicaid preliminary investigations conducted by the OIG.

PAGE 46, PARAGRAH 4
"When MFCU officials determine that a complaint merits investigation, a case is opened, is investigated, and may ultimately be tried in court."

As noted previously, the OIG conducts Medicaid preliminary investigations, which are referred to the OAG.

PAGE 48, PARAGRAPH 1
"In programs such as Food Stamps and K-TAP, the collections are not expected to be significant. In Medicaid, millions of dollars are carried forward from prior years…"

Collections in these programs have been significant. Administrative collections (through benefit reduction, state/federal tax intercept and through cash, check, and money order payments) in the KTAP program totaled $628,504.54 for State Fiscal Year 2003. Administrative collections in the Food Stamps program totaled $2,503,266.84 for State Fiscal Year 2003.

PAGE 48, PARAGRAPH 3
"*Some anticipated collections of overpayments and third-party liability are budgeted to pay Medicaid's administrative expenses and, in some years, to pay benefit cost."*

Since the OIG identifies Medicaid overpayments and third-party information, it would be advantageous for a portion of those collections to be appropriated to the OIG to offset administrative expenses.

PAGE 55, PARAGRAPH 5

In the early 1990's, federal incentives were passed through to Contracting Officials. At that time, the state reimbursed 66% of the expenses of running the office. In 1995, the method of funding the Contracting Officials changed to paying an hourly rate for attorney services and funding 100% of all other costs. The predetermined contract amount establishes a limit for each county's reimbursable cost. In order to continue awarding good performance, $1,000,000 in state funds, was set-aside for performance awards. State funds were used to pay the performance awards in order that the Contracting Officials not be bound to the federal reimbursement rules for using the funds. Officials continued to receive incentives for performance until SFY 2001. In consultation with a workgroup of Contracting Officials, the performance awards were suspended to reduce the impact of the budget shortfall by using the $1,000,000 in state funds to draw down $2,000,000 in federal funds. Since 1994, the amount budgeted for Contracting Official contracts increased from $9,421,000 to $37,433,499 in 2004.

PAGE 60, PARAGRAPH 2

Currently, federal law requires states to pay the federal share of TANF collections that could be retained by the state. This means for every $1 sent to the family, the state is required to pay approximately $.70 to the federal government. Currently, the remaining $.30 is used to operate the Child Support Program. For SFY 2003, passing through the state share of collections to the family in cases that were active KTAP would have reduced state funds by $4.3 million. Passing through the state share of all KTAP collections in both active and former KTAP cases would have decreased the state funds by $9 million. Any amounts passed through to the family in excess of the state share of collections are not considered as child support collections for the Child Support Program and must be paid from state funds. Using data for SFY 2003, passing through all of the federal share of collections in active KTAP cases would cost the state an additional $10 million, and passing through the federal share of all KTAP collections in both active and inactive KTAP cases would cost $21 million. Proposed TANF Reauthorization bills allow states the option of passing through all or part of the TANF collections. If TANF Reauthorization is passed as proposed, states will not be required to pay the federal share on the collections sent to the family. In active KTAP cases, the amount sent to the family must be disregarded in the TANF case.

Without a change in the federal law, any amounts sent to the family must be paid from state funds. If TANF Reauthorization is enacted, as proposed, and Kentucky opts to pass through collections to the family, the Child Support Program will require additional General Funds to operate the program. The amount from the General Fund will depend on the amount of the TANF collections passed through to the family. With the provision to disregard collections sent to the KTAP family, the pass through collections to KTAP families will have no fiscal impact on the K-TAP program.

PAGE 63, PARAGRAPH 3

Staff from the Child Support Program and the Department of Medicaid Services are working together to improve medical support enforcement. The collaboration includes identifying existing insurance, enforcement of orders for insurance, and targeting cases with a high potential for insurance that require the establishment of a medical insurance order. Another component of the collaboration is to investigate an "in lieu of insurance" medical obligation. This debt may be difficult to collect because the financial resources of the non-custodial parent and the Medicaid recipient are similar. Also, the Department of Medicaid Services is investigating an insurance premium supplemental program. When insurance cannot be obtained because the non-custodial parent's wage withholdings are at the limits imposed by the Consumer Credit Protection Act, this program would use Medicaid funds to supplement the amount available from wages to pay the premium.

The Child Support Program will continue to work with the Department of Medicaid Services to improve the establishment and enforcement of medical support. Medical support is a complex issue and this collaboration can provide information that will assist in the development of a medical support program that accomplishes cost savings for the Medicaid program while maintaining medical and financial support for Kentucky families.

If you have any questions, please feel free to contact my office, at 502-564-7042.

Sincerely,

Kevin Payton
Executive Director for Legislative Affairs

Appendix I

Response From the Finance and Administration Cabinet

OFFICE OF THE SECRETARY
FINANCE AND ADMINISTRATION CABINET

383 CAPITOL ANNEX
ERNIE FLETCHER
GOVERNOR

FRANKFORT, KY 40601
(502) 564-4240
(502) 564-6785 Fax

ROBBIE RUDOLPH
SECRETARY

M E M O R A N D U M

To: Cindy Upton
Legislative Research Commission

From: R.B. Rudolph Jr., Secretary
Finance and Administration Cabinet

Date: September 30, 2004

Subject: Response to the Legislative Research Commission's Program Review Report

The Finance and Administration Cabinet has reviewed the Program Review and Investigations Staff Report related to uncollected revenues and improper payments and agrees that significant improvements can be made in accounting for and collecting amounts due the Commonwealth.

We would like to commend the Committee and committee staff for raising the level of awareness of this important issue.

The Finance and Administration Cabinet considers collecting amounts due one of its top priorities. We are rapidly moving to develop the systems and procedures necessary to address the debt collection mandates of HB 162 and SB 228 enacted during the 2004 Regular Session of the General Assembly. When implemented, the Department of Revenue will be able to efficiently and effectively assist in collection of debts for most or all state agencies.

We are pleased to inform the Committee that the Cabinet is already assisting in the collection of delinquent child support. A recently completed computerized interface between the child support system and the Department of Revenue's collection system will assist in collecting of several million dollars in delinquent support annually. In addition, the cooperative agreement between agencies will promote additional voluntary compliance.

Cabinet staff is also actively working with staff of the Administrative Office of the Courts to develop a system to account for and refer debts to the Department of Revenue for collection action. Also underway is a project to develop a common system interface which will allow most state agencies to send their debts to the Department. The Cabinet for Health and Family Services is working with our agency to explore collection opportunities in the area of Medicaid using this interface.

As previously stated, the Finance and Administration Cabinet is committed to addressing many of the issues included in the report. As mentioned by committee staff, full implementation of all of the recommendations on a statewide basis may take a considerable amount of time and resources.

We appreciate the opportunity to respond to the report.

Finance and Administration Cabinet's Response to Chapter 5

September 9, 2004

Introductory Note
The responses provided are applicable to improper payments made by agencies that are under the statutory authority of the Finance and Administration Cabinet. Secretary Rudolph has updated the committee about efforts to improve debt collection. The focus of these responses is ways to improve internal controls to reduce improper payments.

Recommendation 5.1 The Finance and Administration Cabinet (FAC) should establish a formal work group on risk assessment to address improper payments of state money and collection of state debts…..

The Finance and Administration Cabinet agrees with this recommendation; however there is a need for separate workgroups to focus on improper payments and debt collection with one steering committee. FAC will work with the Office of the State Budget Director to study and implement the appropriate work groups.

Subject to further study and discussion, FAC envisions a steering committee comprised of FAC officials, the State Budget Director, and others.

FAC believes that there is a need to bring different expertise to each of two workgroups to assist agencies. One would focus on improper payments. The diminution of improper payment requires the cooperation and dedication of state employees to pre-audit transactions, use appropriate procurement methods, follow guidelines, and safeguard funds. FAC staff from accounting, IT, internal audit, policy and procurement could be the core workgroup. Based upon the unique problems of agencies, this workgroup can assist agencies' employees with identifying risks and developing feasible solutions.

The second workgroup would focus on debt collection. Efforts are underway in the Department of Revenue to increase the collection of debts. Based in part on those lessons learned, this workgroup can assist agencies with improving collection policies, procedures, and techniques.

Recommendation 5.2 State agencies identified by the statewide work group on risk assessment as being most at risk of making improper or unnecessary payment from state funds or not collecting debts that affect the state's fiscal condition should do the following:

The Finance and Administration Cabinet agrees with this recommendation and has implemented portions.

- **Assign responsibility to a senior official…. For establishing policies and procedures for assessing agency and program risk…**

  - FAP 120-07-00 requires each agency head to delegate a fiscal officer. Each agency has signed a delegation agreement with the Office of the Controller to identify a fiscal officer.

    "An agency head shall either serve as or appoint an employee of the agency to serve as fiscal officer with responsibilities including, but not limited to, establishing and maintaining a proper internal control structure, establishing and maintaining the state's accounting system chart of accounts, providing assurances that agency financial reports accurately reflect underlying activity, conducting fiscal operations under GAAP, and acting as a single point of contact with the Office of the State Controller."

  - FAP 120-13-00 Decentralization of the Pre-Audit Function requires agencies to review the details of transactions before they are approved. Each agency has signed a delegation agreement with the Office of the Controller agreeing to perform pre-audits of transactions in MARS.

"Pre-audit shall consist of verification of the validity of claims. Verification shall include an edit applied to a document by the computerized system, as well as review of accounts and elements applied, and review of conformance with applicable rules, regulations or legal requirements. "

- **Develop detailed action plans to determine the nature and extent of improper and unnecessary payments….**

  - The Office of the Controller is drafting an initial survey to help agencies ascertain unique fraud risks.

  - The Office of the Controller is developing an internal control and pre-audit training that will provide agencies tools for risk assessment.

    The objectives of this workshop are to:
    - Convey that the fiscal officer and agency head are responsible for ensuring that internal controls are established, properly documented, maintained and adhered to in each agency, department, division and unit.
    - Convey that all employees of the Commonwealth are responsible for compliance with internal controls.
    - To facilitate assessments of internal controls by giving fiscal officers tools and resources to establish, document, and maintain a system of internal controls.
    - Provide information about the roles and responsibilities of fiscal officers to agency heads before they annually designate fiscal officers.

    Tentative Workshop Agenda:
    - Internal Control Environment
    - Risk Assessment
    - Internal Control Activities
    - Information and Communication
    - Monitoring
    - GAAP
    - Pre-Audit
    - MARS Security
    - Procurement
    - Fixed Assets

- **Identity cost-effective control activities….**

  - The Office of the Controller is drafting a regulation based on SB 228 that will require FAC to review internal control deficiencies and corrective actions identified by agencies.

- **Periodically report to the agency head and FAC on the process made….**

  - The Office of the Controller is drafting a regulation based on SB 228 that will require reporting to Finance and Administration.

Recommendation 5.3 The Court of Justice should do the following:…

- Finance and Administration is willing to work with the Court of Justice.

Recommendation 5.4 FAC and the State Budget Director should issue specific guidance to agencies that provides a comprehensive approach to reducing improper payments and collecting debts…

The Finance and Administration Cabinet agrees with this recommendation and has implemented portions.

- The Office of Policy and Audit has issued a Pre-Audit Manual to assist agencies with identifying improper transactions.
- The internal control training and forthcoming regulation will provide guidance to agencies to reduce improper payments.
- During the training, through the workgroup, and based on specific requests, agencies will be instructed on risk assessments and provided with tools to perform risk assessments on programs and activities within their own agency.
- FAC will assist agencies with process improvement.
- FAC will require agencies to submit known improper payments annually as part of the closing package.
- FAC will specify the format and content of agency reports.

Recommendation 5.5 The General Assembly should consider requiring the Finance and Administration Cabinet to report annually on state agencies' improper and unnecessary payments. The report should include information on error rates, estimates of improper payments, and estimates of unnecessary payments due to action or inaction by state agencies.

The Finance and Administration Cabinet disagrees with this recommendation because it is not feasible to identify every improper payment. Any error rate provided would not be statistically significant.

FAC could report on known improper payments. The report could also contain preventative measures taken by FAC and other agencies. Recently, FAC has taken several steps including the following:

- Added specific documents to the statewide retention schedule to support transactions in MARS.
- Increased the document retention period from 3 to 8 years for most documents that support expenditures.
- Strengthening the internal control components of KARs and FAPs. For example:
    - Travel (200 KAR 2:006)
    - Procard (FAP 111-58-00)
    - Cell phones (FAP 300-01-00)
    - Capital Projects Accounts Closing Process (FAP 220-18-00)
- As a result of reorganization of the Executive Branch, the internal audit branch in the Office of Policy and Audit has increased to six auditors. New duties for these auditors include reviewing agencies' Procard reports submitted to FAC.

Recommendation 5.6 FAC and the State Budget Director should work with state agency officials to help them implement the action plans and internal control and pre-audit policies and procedures developed to reduce improper and unnecessary payment and to collect debts.

The Finance and Administration Cabinet agrees with this recommendation and has taken steps to work with agencies.

- Ongoing/Existing Efforts:
    - Pre-Audit Manual has been provided online to assist agencies.
    - Agency specific accountants are assigned in the Division of Statewide Accounting Services to address agency questions.

- Help desk assistance and MARS training is provided by the Customer Resource Center.
- Conduct large meetings with agencies' fiscal officers and other staff including a meeting with Procard Administrators when the Procard FAP was amended to include specific internal control provisions.

- Planned Efforts:
  - Internal controls training for fiscal officers and other interested employees.
  - Review of agency reports and improvement plans by FAC.
  - Assistance with process improvement.

Recommendation 5.7 FAC, the State Budget Director, the State Treasurer, and the Court of Justice should explore the use of all available collection methods and require or seek authority to require state agencies and the courts to implement all cost-effective methods….

Recommendation 5.7 is related to debt collection.

Recommendation 5.8 FAC should research best practices of those states with central collections units to gain the benefit of their knowledge and experience…

Recommendation 5.8 is related to debt collection.

Recommendation 5.9 FAC and the State Treasurer should develop a statewide policy to ensure that collections are deposited on the day they are received.

The Finance and Administration Cabinet agrees with this recommendation if there is a dollar threshold. It may not be efficient for an agency to immediately deposit $5.00 if it is the only money collected during that day.

FAC will promulgate a regulation or FAP to provide agencies with a broad policy and standards for deposits. The cabinet will work with agencies to develop appropriate internal controls related to deposits.