



THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

August 05, 2005

The Honorable J. Dennis Hastert
Speaker of the House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

Enclosed for the consideration of the Congress are the Administration's draft proposals that would protect and strengthen the financing of the Medicaid program, as described in the President's fiscal year 2006 Budget.

These proposals will help keep Medicaid affordable and sustainable for states and the Federal government by restructuring reimbursement for prescription drugs, reforming rules for long-term care eligibility, and strengthening the program's financial integrity. Specifically, the Administration's proposals would:

- Restructure Medicaid Drug Reimbursement. Currently, the Medicaid program is overpaying for prescription drugs while pharmacies and Medicare can buy drugs wholesale for a lower price. The Administration proposes a system that more closely aligns pharmacy reimbursement with pharmacy acquisition costs by using the average sales price as the basis for Medicaid payment for drugs. Restructuring the current system for setting drug prices in this way would lead to savings for states and the Federal government.
- Reform Transfer of Assets Requirements. Current law penalizes individuals who, in attempting to qualify for Medicaid, inappropriately transfer assets for less than fair market value. Such individuals are subject to a period of ineligibility for Medicaid coverage of long-term care services. However, creative estate planning often results in the penalty period expiring before the individual even applies for Medicaid. This proposal would prevent individuals from avoiding the penalty period, and encourage more individual long-term care planning while focusing Medicaid's resources on those who need it most. This result would lead to substantial savings for states and the Federal government.
- Strengthen Medicaid Financial Integrity. As a Federal-state partnership, states have the flexibility to design and run their own Medicaid programs, subject to Federal requirements. The Federal government matches each state's spending at a particular rate, but some states are using creative cost-shifting methods and loopholes in Medicaid

authority to inflate their Medicaid expenditures. As a result, the amount of Federal reimbursement to such states exceeds the level Congress determined to be appropriate.

To address this problem, this package includes proposals to strengthen Medicaid financial integrity by:

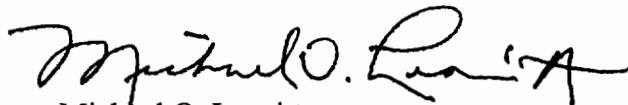
- ▶ restricting the inappropriate use of intergovernmental transfers (IGTs) and other reimbursement maximization strategies;
- ▶ closing loopholes in provider tax provisions;
- ▶ clarifying the definition of targeted case management (TCM) and rehabilitation services, to prevent Medicaid from paying for services that are the responsibility of other programs;
- ▶ reimbursing TCM at the 50 % administrative rate; and
- ▶ replacing open-ended Federal reimbursement for Medicaid administrative costs with a state-specific amount of available Federal funds.

The Department's ability to make Medicaid more affordable to states and the Federal government is dependent upon the enactment of these proposals. These changes will help ensure that Medicaid beneficiaries get the services they need and that Federal Medicaid funds are appropriately spent.

This draft legislation would implement mandatory savings proposals in the President's FY 2006 Budget. The Administration looks forward to working with the Congress to enact reconciliation legislation this year that contains the savings called for by the Congressional budget resolution for FY 2006.

We urge Congress to give these proposals their prompt and favorable consideration. The Office of Management and Budget has advised that enactment of these proposals would be in accord with the President's program.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael O. Leavitt". The signature is fluid and cursive, with a large initial "M" and "L".

Michael O. Leavitt

Enclosure