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SMD# 17-005

**RE: Phase-out of expenditure authority  
for Designated State Health Programs  
(DSHP) in Section 1115 Demonstrations**

**December 15, 2017**

Dear State Medicaid Director:

The Centers for Medicare & Medicaid Services (CMS) has approved a number of demonstration projects, under the authority of section 1115 of the Social Security Act (section 1115 demonstrations) that include providing federal funding for state expenditures for designated state health programs (DSHP) that were previously funded entirely by the state, without federal funds. One stated purpose of federal DSHP funding was to ensure the continuation of these beneficial state programs while the state was incurring additional expenditures for health service delivery reform or expansion under the demonstration project. However, the result has been that many states are not contributing state funds toward these delivery system reform efforts. Instead, these states are primarily relying on dollars freed up by the federal Medicaid contribution to DSHP to draw down additional federal Medicaid matching expenditures to support delivery system reforms.

After reviewing the practice of DSHP funding, CMS has determined that it will no longer accept state proposals for new or renewing section 1115 demonstrations that rely on federal matching funds for DSHP. Federal DSHP funding has raised oversight concerns about its consistency with the federal-state financial partnership established under the Medicaid statute. Moreover, current demonstrations have not made a compelling case that federal DSHP funding is a prudent federal investment. Authority for DSHP in current demonstrations will continue until the end of the state's current demonstration period but will not be extended or renewed. CMS is available to consult with affected states interested in identifying other options to support innovative state section 1115 demonstrations that promote the objectives of Medicaid.

**Background**

Designated State Health Programs (DSHP) are existing state-funded health programs that have not previously qualified for federal funding, including Medicaid. DSHPs existed in the state prior to the section 1115 demonstration. As part of the demonstration, CMS historically allowed the state to count certain expenditures for the program as expenditures under the demonstration that qualify for federal matching funds, allowing the state to use the "freed up" state dollars

towards its Medicaid demonstration. Unlike traditional Medicaid matching funds, which are tied to claims for specific services provided to Medicaid beneficiaries, federal matching funds provided to support DSHP have not necessarily been tied to the extent to which the DSHP serves Medicaid beneficiaries. Since 2005, HHS has authorized several states to draw federal Medicaid matching funds for DSHP under the authority of section 1115(a)(2) of the Act.

### **DSHP Raises Oversight Concerns and Increases Federal Expenditures**

Several states have been authorized to obtain federal Medicaid matching funds for DSHP through section 1115 demonstrations that provide for expanded health coverage and delivery system reforms. The stated purpose of federal DSHP funding under these demonstrations was typically to ensure the continuation of important state programs while the state was making investments in Medicaid delivery system reform or coverage expansion. However, current demonstrations have not made a compelling case that federal DSHP funding is necessary to support the continuation of important programs previously operated by the state, and federal DSHP funding is inconsistent with the overall federal-state financial relationship under the Medicaid statute.

Federal DSHP funding has appeared to serve primarily as a financing mechanism for the state, rather than being an integral part of the delivery system or coverage reforms under the approved section 1115 demonstrations. In most approved demonstrations, the amount of DSHP funding is tied to expenditures under the demonstration for delivery system reform activities, so that the federal DSHP funding frees up state dollars that the state can expend to obtain additional federal match. This, in effect, results in increased federal expenditures without a comparable increase in the state's investment in its demonstration.

CMS has been working to increase internal controls related to documenting that approved DSHPs are likely to assist in promoting the objectives of Medicaid. The use of demonstration authority to match state DSHP expenditures has also been of interest to Congressional oversight committees, and the Government Accountability Office (GAO). As part of these efforts, CMS began requesting additional documentation of demonstration purposes being served by federal DSHP funding in demonstration proposals. CMS also began requiring states to submit claiming protocols to ensure only allowable DSHP costs were matched with federal Medicaid funds.

In general, this documentation has confirmed that federal DSHP funding is primarily used by states to obtain additional federal funds without state match, and not as an integral part of a Medicaid delivery system or coverage reform demonstration. For example, one state's approved DSHP includes an immunization program and tobacco use prevention that previously were funded entirely by the state, without federal Medicaid matching funds, and do not appear integral to the state's section 1115 demonstration supporting delivery system reform. Another state received DSHP for a child growth and nutrition program and for a renal disease program, which were not integral to the state's 1115 demonstration for delivery system reform and coverage expansion.

### **Other Programmatic and Financing Mechanisms Available**

CMS is committed to working with states to help identify other strategies to support innovation and improvement to their Medicaid programs. Delivery system reform and coverage expansion approaches that are effective and efficient should advantage the local, state, and federal governments while maintaining the integrity of the statutory funding structure. CMS is available to consult with states interested in identifying options to support innovative state section 1115 demonstrations that promote the objectives of Medicaid.

### **Next Steps**

In addition to this letter, the Centers for Medicaid and CHIP Services (CMCS) will conduct direct outreach to states with existing DSHPs to emphasize that the authority for DSHP will not be extended beyond the currently approved demonstration period. CMS will work with states with pending demonstration proposals that include DSHP as a funding mechanism to identify other options to support innovative state section 1115 demonstrations that promote the objectives of Medicaid.

Questions and comments regarding this policy may be directed to Judith Cash, Acting Director, State Demonstrations Group, CMCS, at 410-786-9686.

Sincerely,

/s/

Brian Neale  
Director

cc:

National Association of Medicaid Directors  
National Academy for State Health Policy  
National Governors Association  
National Conference of State Legislatures  
American Public Human Services Association  
Association of State and Territorial Health Officials  
Council of State Governments