DEC -7 2005

TO: Mark B. McClellan, M.D., Ph.D.
Administrator
Centers for Medicare & Medicaid Services

FROM: Daniel R. Levinson *Daniel R. Levinson*
Inspector General

SUBJECT: Review of Mississippi's Medicaid Upper-Payment-Limit Calculations for Hospitals and Nursing Facilities (A-04-03-02025)

Attached is an advance copy of our final report on Mississippi's Medicaid upper-payment-limit (UPL) calculations for hospitals and nursing facilities. We will issue this report to Mississippi within 5 business days.

The UPL is a reasonable estimate of the amount that would be paid for Medicaid services under Medicare payment principles. In 2001, the Centers for Medicare & Medicaid Services (CMS) revised Medicaid's UPL regulations (42 CFR §§ 447.272 and 447.321) to require that States calculate a separate UPL for each of the following categories of providers: private facilities, State facilities, and non-State government facilities. Federal funds are not available for State expenditures that exceed these limits.

Our objectives were to determine whether Mississippi calculated:

- the UPLs for non-State government nursing facilities in accordance with Federal regulations and the approved State plan amendment and

- the inpatient and outpatient UPLs for private, State, and non-State government hospitals in accordance with Federal regulations and the approved State plan amendments.

Mississippi calculated the State fiscal years (FYs) 2002 and 2003 UPLs for non-State government nursing facilities in accordance with the revised Federal regulations and the approved State plan amendment.[1] However, for those same years, the State did not comply with the revised Federal regulations or the State plan amendments when calculating the inpatient and outpatient UPLs for private, State, and non-State government hospitals. The State used incorrect Medicare prospective payment system data in the inpatient calculations and an incorrect definition of the UPL in the outpatient calculations. As a result, from October 2000 through December 2002, Mississippi potentially overstated hospital inpatient UPL payments by approximately $183 million and hospital outpatient UPL payments by approximately $41 million. The potential overpayments totaled approximately $224 million ($171 million Federal share).

[1]The State FY begins July 1 and ends June 30.

During our fieldwork, Mississippi began working with CMS to revise its hospital inpatient and outpatient UPL methodologies and calculations. Because the proposed methodologies have not been approved or implemented, we could not analyze or express an opinion on them.

We recommend that Mississippi:

- continue to work with CMS to resolve the potential UPL overpayments of approximately $224 million ($171 million Federal share) for hospital inpatient and outpatient services,

- implement procedures to ensure that future UPL calculations comply with Federal regulations, and

- identify and refund any overpayments made subsequent to our audit period.

In commenting on our draft report, the State said that based on the Hurricane Katrina disaster, it had requested that CMS waive any requirement for the repayment of potential UPL overpayments identified by our audit. The State added that it had implemented procedures to ensure that future UPL calculations comply with Federal regulations and that it was not aware of any overpayments made subsequent to the audit period.

The State's comments did not warrant any revisions to the results of our review or to our recommendations.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or Lori S. Pilcher, Regional Inspector General for Audit Services, Region IV, at (404) 562-7750.

Attachment

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General
Office of Audit Services

REGION IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, Georgia 30303

DEC - 8 2005

Report Number: A-04-03-02025

Mr. Robert L. Robinson, Ph.D.
Executive Director
Office of the Governor
Division of Medicaid
239 North Lamar Street
Jackson, Mississippi 39201-1399

Dear Mr. Robinson:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Mississippi's Medicaid Upper-Payment-Limit Calculations for Hospitals and Nursing Facilities." A copy of this report will be forwarded to the action official noted on the next page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports issued to the Department's grantees and contractors are made available to the public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

If you have any questions or comments about this report, please contact me at (404) 562-7750, or have your staff contact Peter Barbera, Audit Manager, at (404) 562-7758. Please refer to report number A-04-03-02025 in all correspondence.

Sincerely,

Lori S. Pilcher
Regional Inspector General
for Audit Services, Region IV

Enclosures

Direct Reply to HHS Action Official:

Mr. Renard L. Murray, D.M.
Associate Regional Administrator
Division of Medicaid & Children's Health
Centers for Medicare & Medicaid Services
U.S. Department of Health and Human Services
61 Forsyth Street, SW., Suite 4T20
Atlanta, Georgia 30303-8909

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF MISSISSIPPI'S MEDICAID UPPER-PAYMENT-LIMIT CALCULATIONS FOR HOSPITALS AND NURSING FACILITIES

Daniel R. Levinson
Inspector General

DECEMBER 2005
A-04-03-02025

Office of Inspector General

http://oig.hhs.gov

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Upper Payment Limits

The upper payment limit (UPL) is a reasonable estimate of the amount that would be paid for Medicaid services under Medicare payment principles. In 2001, the Centers for Medicare & Medicaid Services (CMS) revised Medicaid's UPL regulations for nursing facilities and hospitals.

The revised regulations changed the manner in which States calculate the UPL for various categories of providers. Pursuant to the former rule, States were required to calculate a UPL for all facilities and another UPL for State-owned facilities. The revised regulations instead require States to calculate a separate UPL for each of the following categories of providers: private facilities, State facilities, and non-State government facilities. The regulations also created transition periods in which eligible States were allowed to make payments up to the category-specific UPL plus an excess amount (calculated based on the portion of Medicaid payments that exceeded the UPL in the applicable base year). Federal matching funds are not available for State expenditures that exceed these limits.

Mississippi's Upper-Payment-Limit History

Effective October 1, 2000, Mississippi amended its State plan to provide for UPL payments to State hospitals for inpatient services. After the effective date of the revised regulations (March 13, 2001), State plan amendments expanded UPL payments to all categories of providers (private, State, and non-State government) for hospital inpatient, hospital outpatient, and nursing facility services.

OBJECTIVES

Our objectives were to determine whether Mississippi calculated:

- the UPLs for non-State government nursing facilities in accordance with Federal regulations and the approved State plan amendment and

- the inpatient and outpatient UPLs for private, State, and non-State government hospitals in accordance with Federal regulations and the approved State plan amendments.

SUMMARY OF FINDINGS

Mississippi calculated the State fiscal years (FYs) 2002 and 2003 UPLs for non-State government nursing facilities in accordance with Federal regulations and the approved State plan amendment.[1] However, for State FYs 2002 and 2003, the State did not comply with Federal

[1]The State FY begins July 1 and ends June 30.

regulations or the State plan amendments when calculating the inpatient and outpatient UPLs for private, State, and non-State government hospitals. The State used incorrect Medicare prospective payment system data in the inpatient calculations and an incorrect definition of the UPL in the outpatient calculations. As a result, from October 2000 through December 2002, Mississippi potentially overstated hospital inpatient UPL payments by approximately $183 million and hospital outpatient UPL payments by approximately $41 million. The potential overpayments totaled approximately $224 million ($171 million Federal share).

During our fieldwork, Mississippi began working with CMS to revise its hospital inpatient and outpatient UPL methodologies and calculations. Because the proposed methodologies have not been approved or implemented, we could not analyze or express an opinion on them.

RECOMMENDATIONS

We recommend that Mississippi:

- continue to work with CMS to resolve the potential UPL overpayments of approximately $224 million ($171 million Federal share) for hospital inpatient and outpatient services,

- implement procedures to ensure that future UPL calculations comply with Federal regulations, and

- identify and refund any overpayments made subsequent to our audit period.

STATE'S COMMENTS

In commenting on our draft report, the State said that based on the Hurricane Katrina disaster, it had requested that CMS waive any requirement for the repayment of potential UPL overpayments identified by our audit. The State added that it had implemented procedures to ensure that future UPL calculations comply with Federal regulations and that it was not aware of any overpayments made subsequent to the audit period. (See the appendix for the State's complete comments.)

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The State's comments did not warrant any revisions to the results of our review or to our recommendations.

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INTRODUCTION

BACKGROUND

Our audit was part of a multistate review of upper-payment-limit (UPL) calculations.

Medicaid Program

Title XIX of the Social Security Act (the Act) authorizes Federal grants to States for Medicaid programs that provide medical assistance to needy persons. Each State Medicaid program is jointly financed by the Federal and State Governments and administered by the State in accordance with a State plan approved by the Centers for Medicare & Medicaid Services (CMS). While the State has considerable flexibility in designing its plan and operating its Medicaid program, it must comply with Federal requirements. The Federal Government pays its share of Medicaid expenditures to a State according to a formula contained in section 1905(b) of the Act.

The Mississippi Division of Medicaid (the State agency) administers the Medicaid program at the State level, and CMS administers the program at the Federal level.

Upper Payment Limits

State Medicaid programs have flexibility in determining payment rates for Medicaid providers. CMS has allowed States to use different rates to pay nursing facilities and hospitals as long as the payments, in total, do not exceed the UPL.[1] The UPL is a reasonable estimate of the amount that would be paid for Medicaid services under Medicare payment principles.

To limit abuses in the application of UPL requirements, in 2001 CMS revised its regulations (42 CFR §§ 447.272 and 447.321). The revised regulations require States to calculate a separate UPL for each category of provider.[2] The regulations also created transition periods in which eligible States were allowed to make payments up to the category-specific UPL plus an excess amount (calculated based on the portion of Medicaid payments that exceeded the UPL in the applicable base year). Federal funds are not available for State expenditures that exceed these limits.

Federal regulations do not specify how States should calculate the UPL; however, a State's methodology and related UPL payments must comply with a CMS-approved State plan. In response to public comments on its 2001 proposed regulations, CMS said that States could use either Medicare cost reimbursement principles or prospective payment systems as the foundation of their estimates (66 Federal Register 3147, 3153).

[1]For non-State government hospitals, Federal regulations allowed Medicaid payments up to 150 percent of the UPL from March 13, 2001, to May 14, 2002.

[2]The three categories are privately owned and operated, State government owned or operated, and non-State government owned or operated facilities.

Mississippi's Upper-Payment-Limit History

Effective October 1, 2000, Mississippi amended its State plan to provide for UPL payments to State hospitals for inpatient services. After the effective date of the revised regulations (March 13, 2001), State plan amendments expanded UPL payments to all categories of providers (private, State, and non-State government) for hospital inpatient, hospital outpatient, and nursing facility services. Mississippi's approved State plan amendments stipulated that UPL payments for those services would be in accordance with applicable Federal laws and regulations.

Mississippi makes bimonthly UPL payments, in addition to basic Medicaid payments, to reimburse providers up to the level that Medicare would pay for services rendered. From October 2000 through December 2002, the State made about $368.3 million ($271.1 million Federal share) in UPL payments, as follows:

- $9.7 million to non-State government nursing facilities,
- $84 million to State hospitals for inpatient services,
- $92.6 million to non-State government hospitals for inpatient services,
- $134.9 million to private hospitals for inpatient services, and
- $47.1 million to all categories of hospitals for outpatient services.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The objectives of our review were to determine whether Mississippi calculated:

- the UPLs for non-State government nursing facilities in accordance with Federal regulations and the approved State plan amendment and
- the inpatient and outpatient UPLs for private, State, and non-State government hospitals in accordance with Federal regulations and the approved State plan amendments.

Scope

Our review covered the $368.3 million in UPL payments made from October 1, 2000, through December 31, 2002.

We reviewed certain internal controls relating to the UPL calculations and payments. We did not review the overall internal control structure of the State agency, the nursing facilities, or the hospitals because we accomplished the audit objectives through substantive testing.

We conducted fieldwork at the State agency in Jackson, MS.

Methodology

To accomplish our objectives, we:

- reviewed Federal laws and regulations pertaining to UPL payments;
- compared Federal regulatory requirements with the methodology for calculating UPLs established in State plan amendments 01-27 (nursing facilities), 00-15 and 01-12 (inpatient hospitals), and 01-26, as superseded by 02-22 on May 1, 2002 (outpatient hospitals);
- met with CMS regional office staff in Atlanta, GA, and reviewed their records pertaining to Mississippi's Medicaid program;
- held discussions with CMS central office personnel and members of CMS's National Institutional Reimbursement Team and outpatient reimbursement group;
- interviewed State agency and contractor personnel regarding procedures for calculating UPLs;
- reviewed the State fiscal years (FYs) 2002 and 2003 nursing facility UPL calculations, which served as the basis for UPL payments made for State FYs 2002 and 2003 and which supported nursing facility UPL estimates of $13.4 million per year;[3]
- reviewed the State FY 2002 hospital inpatient and outpatient UPL calculations, which served as the basis for UPL payments made for State FYs 2001 and 2002 and which supported hospital inpatient and outpatient UPL estimates of $143.7 million and $44.4 million, respectively;
- reviewed the State FY 2003 hospital inpatient and outpatient UPL calculations, which served as the basis for UPL payments made for State FY 2003 and which supported hospital inpatient and outpatient UPL estimates of $127.2 million and $47.3 million, respectively;[4] and
- reviewed the reasonableness of the Medicare diagnosis-related group (DRG) data included in the State's revised inpatient calculations for State FYs 2002 and 2003.

We traced the $311.5 million in hospital inpatient UPL payments to the CMS-64 quarterly expenditure reports to determine whether the payments were claimed for Federal

[3]The State FY begins July 1 and ends June 30.

[4]We reviewed the State FY 2003 calculations only to the extent necessary to determine whether they included the same methodology used in the State FY 2002 calculations.

reimbursement.[5] We also traced the $47.1 million in hospital outpatient UPL payments to the CMS-64 quarterly expenditure reports to determine whether the payments were claimed for Federal reimbursement. Through September 2003, the State had not claimed $6 million of the $47.1 million on the CMS-64. Therefore, we excluded the $6 million from our calculation of potential overpayments.

We performed this audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Mississippi calculated the State FYs 2002 and 2003 UPLs for non-State government nursing facilities in accordance with Federal regulations and the approved State plan amendment. However, for State FYs 2002 and 2003, the State did not comply with Federal regulations or the State plan amendments when calculating the inpatient and outpatient UPLs for private, State, and non-State government hospitals. As a result, Mississippi potentially overstated hospital UPL payments by approximately $224 million ($171 million Federal share).

During our fieldwork, Mississippi began working with CMS to revise its hospital inpatient and outpatient UPL methodologies and calculations. Because the proposed methodologies have not been approved or implemented, we could not analyze or express an opinion on them.

INPATIENT UPPER-PAYMENT-LIMIT CALCULATIONS

Mississippi's calculations of the private, State, and non-State government hospital inpatient UPLs did not comply with the "reasonable estimate" requirement of Federal regulations. The calculations included incorrect Medicare prospective payment system data because the State did not have adequate procedures to properly and accurately calculate the UPLs. Consequently, the State made potential hospital inpatient UPL overpayments of approximately $183 million ($140 million Federal share).

Federal and State Requirements

Federal regulations (42 CFR § 447.272) define the inpatient UPL as a reasonable estimate of the amount that would be paid for inpatient Medicaid services under Medicare payment principles. Pursuant to 42 CFR § 447.304, Federal funds are not available for Medicaid payments that exceed this limit.

State plan amendment 00-15, as superseded by 01-12, requires that inpatient UPL payments be in accordance with applicable Federal laws and regulations.

[5]We did not trace $91.7 million of the $311.5 million total paid before October 2001 to the CMS-64. Instead, we asked the State about these payments, and the State said that the payments were included on line 1A, "Inpatient Hospital – Regular Payments" on the September 30, 2001, CMS-64.

Incorrect Prospective Payment System Data

The State used Medicare prospective payment system data as the basis for calculating inpatient UPL payments from October 2000 through December 2002. Under the prospective payment system, Medicare reimburses inpatient hospitals at predetermined rates depending on the illness and its classification in a DRG. The State's UPL calculations, however, included Medicare DRGs that were inappropriate for the admitting diagnoses. Based on its calculations, the State made $311.5 million of inpatient UPL payments. We believe that $128.5 million of the $311.5 million is reasonable and that $183 million is unreasonable.

The State used Medicaid claims for the period July 1998 through June 1999 to determine the inpatient UPLs. For each claim, the State converted the primary diagnosis code into a Medicare DRG. Using a procedure code manual, we reviewed the DRG conversion for one hospital and converted the primary diagnosis codes into the appropriate Medicare DRGs. For those primary diagnosis codes that matched more than one Medicare DRG, we selected the DRG with the highest reimbursement possible.

DRGs assigned by the State generally were not appropriate for the diagnoses. For example, for a claim with a primary diagnosis code of 00861 (Gastroenteritis/Intestinal Infection Enteritis Due to Rotavirus), the State assigned DRG 468 (Extensive Operating Room Procedure Unrelated to Principal Diagnosis) and determined that Medicare would have paid $13,573. However, our conversion of this diagnosis code indicated that the correct assignment should have been DRG 182, 183, or 184 (all of which apply to Esophagitis, Gastroenteritis & Miscellaneous Digestive Disorders). We determined that the Medicare reimbursement would have been $2,333, $1,483, or $1,985 depending on the presence or absence of complications and the patient's age.

After we disclosed these inappropriate DRG assignments, State officials advised us that they had incorrectly assumed that Medicaid would always pay less than the Medicare DRG rate. When the State found that this assumption was not always true, it adjusted its DRG conversion accordingly. For example, the State's Medicaid payment for the claim in the example above was $7,864. When the State discovered that the appropriate Medicare DRG did not cover this amount, the State selected a DRG that would—often leading to a Medicare DRG payment that greatly exceeded the Medicaid payment. Because this was a procedural error that affected all hospitals, the UPL calculations and the related payments were overstated.

When the State asked to correct the DRGs, we suspended our review of the DRG conversion. Subsequently, State officials corrected the DRGs and submitted to CMS a revised UPL calculation supporting $128.5 million of the $311.5 million in inpatient UPL payments. Based on additional testing, we accepted the reasonableness of the revised DRGs and the $128.5 million in UPL payments. However, we believe that the remaining $183 million ($140 million Federal share) is a potential overpayment.

State's Proposed Revisions

According to State officials, the $183 million is not necessarily an overpayment. Citing CMS action taken in other States as precedent, the State used various acuity adjustments for maternity and infant-related services to increase DRGs, resulting in a higher UPL. Those adjustments,

which were separate from acuity adjustments built into the DRG rates, were intended to account for the higher Medicaid utilization and costs of maternity and infant services when compared with Medicare. In addition, the State proposed an entirely new methodology for calculating the UPLs based on the average Medicare reimbursement per discharge.

The State continues to work with CMS regarding the acuity adjustments and the proposed methodology. Because these revisions have not been approved or implemented, we could not analyze or render an opinion on them.

OUTPATIENT UPPER-PAYMENT-LIMIT CALCULATIONS

Mississippi did not comply with the "reasonable estimate" requirement of Federal regulations when calculating the hospital outpatient UPLs for private, State, and non-State government hospitals. The State is currently negotiating with CMS on the allowability of outpatient UPL payments.

Federal and State Requirements

Federal regulations (42 CFR § 447.321) define the outpatient UPL as a reasonable estimate of the amount that would be paid for outpatient Medicaid services under Medicare payment principles. Pursuant to 42 CFR § 447.304, Federal funds are not available for Medicaid payments that exceed this limit.

Mississippi's State plan amendment 01-26, as superseded by 02-22, states that the amount that Medicare would have paid will be calculated and compared with Medicaid basic payments to determine the additional amount that could be paid to reach the outpatient UPL. The amendment requires that outpatient UPL payments be in accordance with applicable Federal laws and regulations.

Incorrect Definition of Upper Payment Limit

The State calculated and used an outpatient UPL estimate that did not comply with Federal regulations or the approved State plan amendment. Instead of calculating the UPL based on a reasonable estimate of what Medicare would pay, the State chose to rely on its estimate of Medicaid costs. This methodology is incorrect and has no basis in regulation or the State plan amendment.

Based on its methodology for calculating the UPL, the State made outpatient UPL payments totaling $47 million from April 2001 through December 2002. As of September 2003, the State had claimed on the CMS-64 only $41 million of the $47 million. Because the methodology used was incorrect, we believe that the $41 million is unallowable.

State's Proposed Revision

After being informed of our concerns late in our audit fieldwork, the State proposed new hospital outpatient UPL calculations to CMS. Because the proposed methodology has not been approved or implemented, we could not analyze or express an opinion on it.

RECOMMENDATIONS

We recommend that Mississippi:

- continue to work with CMS to resolve the potential UPL overpayments of approximately $224 million ($171 million Federal share) for hospital inpatient and outpatient services,

- implement procedures to ensure that future UPL calculations comply with Federal regulations, and

- identify and refund any overpayments made subsequent to our audit period.

STATE'S COMMENTS

In commenting on our draft report, the State said that it had submitted a request to CMS to waive any requirement for the repayment of potential UPL overpayments identified by our audit. The State noted that its request was based on the "dire financial strain" placed on the State in the wake of the Hurricane Katrina disaster. The State added that it had implemented procedures to ensure that future UPL calculations comply with Federal regulations and that it was not aware of any overpayments made subsequent to the audit period. (See the appendix for the State's complete comments.)

OFFICE OF INSPECTOR GENERAL'S RESPONSE

The State's comments did not warrant any revisions to the results of our review or to our recommendations.

APPENDIX

APPENDIX

STATE OF MISSISSIPPI
OFFICE OF THE GOVERNOR
DIVISION OF MEDICAID
ROBERT L. ROBINSON, Ph.D.
EXECUTIVE DIRECTOR

Report Number: A-04-03-02025

Lori S. Pilcher
Regional Inspector General
for Audit Services, Region IV
61 Forsyth Street, S.W., Suite 3T41
Atlanta, GA 30303

Dear Ms. Pilcher,

The Office of the Governor for the State of Mississippi - Division of Medicaid (the Division) has reviewed your draft report titled "Review of Mississippi's Medicaid Upper Payment Limits for Hospitals and Nursing Facilities." Please find below the Division's responses to your recommendations.

1. The Division submitted a request to CMS in September 2005 related to the potential UPL overpayments of approximately $224 million ($171 million Federal share) identified in your report for hospital inpatient and outpatient services. The Division requested that CMS waive any requirement for the repayment of UPL funds based the OIG audit report for the years ended 9/30/00 to 9/30/02 based on the dire financial strain placed on the state in the wake of the Hurricane Katrina disaster. We have not received a response from CMS related to this request to date.

2. The Division has implemented the necessary procedures to ensure that future UPL calculations comply with Federal regulations.

3. The Division implemented changes immediately based on recommendations from the OIG Audit Staff, and we are not aware of any overpayments made subsequent to the audit period.

Please contact David Maatallah of my staff at 601-359-6130 or rbdam@medicaid.state.ms.us if you have any questions related to the above responses.

Sincerely,

Bobby Moody
Deputy Administrator of Administrative Services