DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

SEP 28 2005

TO: Dennis G. Smith
Director, Center for Medicaid and State Operations
Centers for Medicare & Medicaid Services

FROM: Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Indiana's Medicaid Upper Payment Limits for State Fiscal Years 2001 and 2002 (A-05-03-00068)

Attached is an advance copy of our final report on Indiana's Medicaid upper payment limits (UPLs) for State fiscal years 2001 and 2002. We will issue this report to the Indiana Medicaid agency within 5 business days. We conducted the audit as part of a multistate review of UPL calculations at the request of the Centers for Medicare & Medicaid Services (CMS).

The UPL is an estimate of the aggregate amount that would be paid for Medicaid services under Medicare payment principles. In 2001, CMS revised Medicaid's UPL regulations for hospitals and nursing homes to require States to 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 Medicaid payments that exceed these limits.

Indiana made UPL payments to non-State government hospitals and nursing homes. Indiana also made disproportionate share hospital (DSH) payments to hospitals that served disproportionate numbers of low-income patients with special needs. DSH payments to a hospital are prohibited from exceeding the hospital-specific limit, which is generally defined as the cost of uncompensated care. States must consider UPL payments when calculating DSH limits.

Our objectives were to determine whether Indiana (1) calculated the UPL for non-State government hospitals in accordance with Federal regulations and the approved State plan amendment and properly included UPL payments in the calculation of hospital-specific DSH limits and (2) calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

Indiana overstated the amounts available for UPL payments to non-State government hospitals by about $2.2 million for State fiscal year 2001 and by about $4.3 million for State fiscal year 2002. Indiana overstated those amounts primarily because it included unpaid Medicaid claims in its UPL calculations for many of the hospitals. The calculations were contrary to the State plan provisions because the calculations included unpaid claims rather than Medicaid payments. Medicaid had denied payment of the claims because the hospitals had not filed the claims within Indiana's 1-year Medicaid time limit.

Although the UPL is an aggregate limit, the State plan covering the audit period essentially imposed a hospital-specific limit on the payments. According to the State plan, an individual non-State government hospital shall receive UPL payments equal to the difference between (1) the amount of Medicaid payments made to that hospital pursuant to Medicaid reimbursement provisions and (2) an amount equal to a reasonable estimate of the amount that hospital would have been paid for those services under Medicare payment principles (as adjusted to 150 percent for certain periods as allowed by Federal regulations). Because the amounts available for UPL payments for the individual hospitals were overstated, Indiana made unallowable UPL payments to many non-State government hospitals. The unallowable payments to the hospitals for the 2-year period totaled $5,114,702 ($3,173,161 Federal share).

Indiana properly included the UPL payments to hospitals in the calculation of hospital-specific DSH limits. In addition, Indiana calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

We recommend that Indiana:

- refund $3,173,161 to the Federal Government and

- revise its UPL methodology to exclude unpaid Medicaid claims from the calculations.

In its comments on our draft report, Indiana stated that Federal regulations and the State plan supported the inclusion of Medicaid unpaid days in the UPL calculations. Indiana included several reasons for its position and concluded that it should not be required to refund the $3,173,161 Federal share.

We continue to believe that the State's UPL calculations should not include Medicaid unpaid claims. Because the time limits for filing the claims had expired, the services did not qualify for Medicaid payment under the State plan. Under Indiana's rationale, the inclusion of unpaid claims in the UPL calculations would effectively circumvent the State's 1-year Medicaid claim filing requirement for those hospitals receiving UPL payments.

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 Paul Swanson, Regional Inspector General for Audit Services, Region V, at (312) 353-2618.

Attachment

DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF AUDIT SERVICES
233 NORTH MICHIGAN AVENUE
CHICAGO, ILLINOIS 60601

REGION V
OFFICE OF
INSPECTOR GENERAL

SEP 30 2005

Report Number: A-05-03-00068

Ms. Jeanne Labrecque
Director, Office of Health Policy and Medicaid
Indiana Family and Social Services Administration
402 West Washington Street, Room W382
Indianapolis, Indiana 46204-2739

Dear Ms. Labrecque:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Indiana's Medicaid Upper Payment Limits for State Fiscal Years 2001 and 2002." A copy of this report will be forwarded to the action official noted below 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. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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Please refer to report number A-05-03-00068 in all correspondence.

Sincerely,

Paul Swanson

Paul Swanson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Ms. Verlon Johnson
Associate Regional Administrator
Division of Medicaid and Children's Health
Centers for Medicare & Medicaid Services
Department of Health and Human Services
233 North Michigan Avenue, Suite 600
Chicago, Illinois 60601-5519

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF INDIANA'S MEDICAID UPPER PAYMENT LIMITS FOR STATE FISCAL YEARS 2001 AND 2002

Daniel R. Levinson
Inspector General

SEPTEMBER 2005
A-05-03-00068

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 an estimate of the aggregate 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 hospitals and nursing homes.

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 funds are not available for State expenditures that exceed these limits.

Indiana's State plan amendments authorized UPL payments to non-State government hospitals and nursing homes. The amendments provided that individual hospitals and nursing homes could receive UPL payments equal to the difference between what Medicaid paid for the services and what Medicare would have paid for the services. Payments under Indiana's State plan amendments did not qualify for a transition period.

Disproportionate Share Hospital Payments

Section 1923 of the Social Security Act requires States to make Medicaid disproportionate share hospital (DSH) payments to hospitals that serve disproportionate numbers of low-income patients with special needs. Section 1923 prohibits these payments from exceeding the hospital-specific DSH limit, which is generally defined as the cost of uncompensated care. States must consider UPL payments and other payments received on behalf of Medicaid and uninsured patients when calculating hospital-specific DSH payment limits.

OBJECTIVES

Our objectives were to determine whether Indiana:

- calculated the UPL for non-State government hospitals in accordance with Federal regulations and the approved State plan amendment and properly included UPL payments in the calculation of hospital-specific DSH limits and

- calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

SUMMARY OF FINDINGS

Indiana overstated the amounts available for UPL payments to non-State government hospitals by about $2.2 million for State fiscal year (SFY) 2001 and by about $4.3 million for SFY 2002. Indiana overstated those amounts primarily because it included unpaid Medicaid claims in its UPL calculations for many of the hospitals. The calculations were contrary to the State plan provisions because the calculations included unpaid claims rather than Medicaid payments. Medicaid had denied payment of the claims because the hospitals had not filed the claims within Indiana's 1-year Medicaid time limit. Indiana also (1) used an incorrect Medicare cost-to-charge ratio that caused an understatement for one hospital and (2) overstated hospital graduate medical education expenses.

Although the UPL is an aggregate limit, the State plan covering the audit period essentially imposed a hospital-specific limit on the payments. According to the State plan, an individual non-State government hospital shall receive UPL payments equal to the difference between (1) the amount of Medicaid payments made to that hospital pursuant to Medicaid reimbursement provisions and (2) an amount equal to a reasonable estimate of the amount that hospital would have been paid for those services under Medicare payment principles (as adjusted to 150 percent for certain periods). Because the amounts available for UPL payments for the individual hospitals were overstated, Indiana made unallowable UPL payments to many non-State government hospitals. The unallowable payments to the hospitals for the 2-year period totaled $5,114,702 ($3,173,161 Federal share).

Indiana properly included the UPL payments to hospitals in the calculation of hospital-specific DSH limits. In addition, Indiana calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

RECOMMENDATIONS

We recommend that Indiana:

- refund $3,173,161 to the Federal Government and
- revise its UPL methodology to exclude unpaid Medicaid claims from the calculations.

STATE'S COMMENTS

It its comments on our draft report, Indiana disagreed with our position concerning unpaid claims and did not address its use of an incorrect cost-to-charge ratio or the overstatement of graduate medical education expenses. Indiana presented several rationales for its position that Federal regulations and the State plan supported the inclusion of Medicaid unpaid days in the UPL calculations and concluded that it should not be required to refund the $3,173,161 Federal share. We included Indiana's comments in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We continue to believe that the State's Medicaid UPL calculations should not include Medicaid unpaid claims. Because the time limits for filing the claims had expired, the services did not qualify for Medicaid payment under the State plan. Under Indiana's rationale, the inclusion of unpaid claims in the UPL calculations would effectively circumvent the State's 1-year Medicaid claim filing requirement for those hospitals receiving UPL payments.

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INTRODUCTION

BACKGROUND

Our audit was part of a multistate review of upper-payment-limit (UPL) calculations conducted at the request of the Centers for Medicare & Medicaid Services (CMS).

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 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 shown in section 1905(b) of the Act. Within the Federal Government, CMS administers the program.

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 hospitals and nursing homes as long as the payments, in total, do not exceed the UPL.[1] The UPL is an estimate of the aggregate amount that would be paid for Medicaid services under Medicare payment principles.

To limit abuses in the application of UPL requirements, CMS revised its regulations (42 CFR §§ 447.272 and 447.321) in 2001. 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.

Disproportionate Share Hospital Payments

Section 1923 of the Act requires States to make disproportionate share hospital (DSH) payments to hospitals that serve disproportionate numbers of low-income patients with special needs. Section 1923 prohibits these payments from exceeding the hospital-specific DSH limit, generally considered as the amount of incurred uncompensated care costs.

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[1]For non-State government hospitals, Federal regulations allowed Medicaid payments up to 150 percent of a reasonable estimate of the amount that would be paid for the services by the group of facilities under Medicare payment principles 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.

Uncompensated care costs are the costs of medical services provided to Medicaid and uninsured patients, less payments received for those patients. States must consider UPL payments and other payments received on behalf of Medicaid and uninsured patients when calculating hospital-specific DSH payment limits**.**

Indiana's Upper-Payment-Limit Methodology

In Indiana, the Indiana Family and Social Services Administration administers the Medicaid program. Two State plan amendments authorized UPL payments to non-State government hospitals and nursing homes. One amendment, covering hospitals, became effective during State fiscal year (SFY) 2001. The other amendment, covering nursing homes, was effective with SFY 2002. Both amendments provided that individual facilities could receive UPL payments equal to the difference between what Medicaid paid for services and what Medicare would have paid for the services. Payments to hospitals and nursing homes under the State plan amendments did not qualify for a transition period.

Indiana calculated separate UPLs for hospitals and nursing homes. The calculations first established the amounts that Medicare would have paid for the furnished Medicaid services and then calculated the differences between those amounts and the amounts that Medicaid paid for the services.[3] The differences represented funds that could be available as UPL payments to hospitals and nursing homes.

Although the UPL is an aggregate limit, the Indiana State plan covering the audit period effectively imposed a hospital-specific limit on the UPL payments to specific hospitals. The State plan provided that "A Municipal Hospital [non-State government hospital] . . . shall receive, in addition to its allowable regular Medicaid claims payments to which it is entitled, a payment adjustment calculated in the following manner . . . ."

The State plan provided that this payment adjustment would be calculated for each individual hospital, essentially, as the difference between (1) the amount of Medicaid payments made to that hospital pursuant to Medicaid reimbursement provisions and (2) an amount equal to a reasonable estimate of the amount that hospital would have been paid for those services under Medicare payment principles (as adjusted to 150 percent for certain periods). The State plan did not include provisions for a hospital to receive more than this payment adjustment.[4]

[3]For certain periods, as allowed by Federal regulations, the calculations for non-State government hospitals were adjusted upward to reflect 150 percent of what Medicare would have paid for the services.

[4]The State plan was amended effective July 1, 2003, to provide that individual hospitals could receive less than or more than the amounts available for individual hospital UPL payments as long as Medicaid payments for the services (excluding DSH payments), in the aggregate, did not exceed a reasonable estimate of the amount that would be paid for those services under Medicare payment principles.

For SFYs 2001 and 2002, Indiana made UPL payments to hospitals amounting to $22.7 million and $131.5 million, respectively. For SFY 2002, Indiana made UPL payments to nursing homes amounting to $16.8 million.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine whether Indiana:

- calculated the UPL for non-State government hospitals in accordance with Federal regulations and the approved State plan amendment and properly included UPL payments in the calculation of hospital-specific DSH limits and

- calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

Scope

Our audit covered SFYs 2001 and 2002. Because Indiana had not yet compiled the data for SFY 2002, our review of the hospital-specific DSH limits included only SFY 2001. We did not evaluate internal controls.

We performed fieldwork in Indianapolis, IN, at the offices of the contractor that prepared the UPL calculations for the State.

Methodology

To accomplish our objectives, we reviewed Indiana's UPL calculations, UPL payments, and supporting documentation. For 10 selected hospitals and 5 selected nursing homes, we made a comprehensive review of the facility-specific documentation. Because the overall procedures were essentially the same in SFYs 2001 and 2002, we initially focused our review on the calculation methodology and documentation for SFY 2002. We then expanded our review to include SFY 2001 when necessary to address any audit exceptions.

The facility-specific documentation generally consisted of State-compiled claims and payment data and provider cost reports. We did not evaluate the accuracy of the information presented in that documentation. We reviewed facility-specific payment data to determine whether Indiana appropriately considered UPL payments when calculating the hospital-specific DSH payment limits.

We conducted our audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Indiana overstated the amounts available for UPL payments to non-State government hospitals by about $2.2 million for SFY 2001 and by about $4.3 million for SFY 2002. Because the amounts calculated by Indiana as available for UPL payments for the individual hospitals were overstated, and when considering that the State plan effectively imposed a hospital-specific limit on the payments, Indiana made unallowable UPL payments to many non-State government hospitals. Indiana made unallowable UPL payments of $2,074,133 to 37 hospitals for SFY 2001 and $3,040,569 to 39 hospitals for SFY 2002. The unallowable payments to the hospitals for the 2-year period totaled $5,114,702 ($3,173,161 Federal share).

Indiana properly included the UPL payments to hospitals in the calculation of hospital-specific DSH limits. In addition, Indiana calculated the UPL for non-State government nursing homes in accordance with Federal regulations and the approved State plan amendment.

OVERSTATED UPPER-PAYMENT-LIMIT CALCULATIONS

Indiana overstated the amounts available for UPL payments to individual non-State government hospitals by $2,158,361 for SFY 2001 and $4,316,898 for SFY 2002. Specifically, Indiana (1) included unpaid claims, (2) used an incorrect cost-to-charge ratio for one hospital, and (3) overstated graduate medical education expenses.

The amounts of our audit adjustments, by year, are as follows:

Table 1: Audit Adjustments

	Overstated (or Understated)	
	SFY 2001	**SFY 2002**
Inclusion of unpaid claims	$2,158,361	$4,494,947
Use of incorrect cost-to-charge ratio	-	(300,599)
Overstatement of graduate medical education	-	122,550
	$2,158,361	**$4,316,898**

Unpaid Claims

When estimating the amounts that Medicare would have paid for Medicaid hospital services, Indiana included data for certain inpatient and outpatient hospital claims that Medicaid had never paid. Medicaid had denied payment of the claims because the hospitals had not filed the claims within Indiana's 1-year Medicaid time limit.

Pursuant to the Indiana Administrative Code, section 405 IAC 1-1-3, all Medicaid provider claims for services rendered to beneficiaries must be originally filed with the Medicaid contractor within 12 months of the service dates. Although hospitals filed claims after this

1-year billing limitation, Indiana believed that its UPL calculations could nonetheless include the unpaid claims because they met the 2-year Medicare filing limitation.

State plan provisions covering inpatient services (Attachment 4.19A) and outpatient services (Attachment 4.19B) specify that a non-State government hospital may receive UPL payments:

> . . . equal to the difference between:
>
> (a) The amount of Medicaid payments to the hospital made pursuant to the Medicaid reimbursement provisions under . . . the Indiana Code, excluding DSH payments made pursuant to Indiana Code . . . for services provided by the hospital during the state fiscal year, and
>
> (b) an amount equal to . . . a reasonable estimate by [Indiana] of the amount that would have been paid for those services under Medicare payment principles . . . .

The State plan also included provisions to increase the amount calculated under item (b), above, to reflect 150 percent of the amount under Medicare payment principles for certain periods as allowed by Federal regulations. (See footnote 1.)

Indiana's calculations were contrary to the State plan provisions because the calculations included unpaid claims rather than "Medicaid payments." Since the time limit for filing the claims had expired, the services did not qualify for Medicaid payment under the Indiana Code.

The inclusion of unpaid Medicaid claims data in the UPL calculations for individual hospitals overstated the amounts available for UPL payments by $2,158,361 for SFY 2001 and by $4,494,947 for SFY 2002. Most hospitals were affected.

Incorrect Cost-to-Charge Ratio

Through an oversight, Indiana used an incorrect Medicare inpatient cost-to-charge ratio when calculating the UPL for one hospital[5] for SFY 2002. This error occurred when the cost-to-charge ratio for another facility was mistakenly used. As a result of the error, Indiana understated the amount available for UPL payments to the hospital by $300,599.

Graduate Medical Education Expenses

When estimating the amounts that Medicare would have paid for Medicaid services, Indiana overstated graduate medical education expenses for SFY 2002. The expenses were overstated by $122,550 due to an error in the calculation.

[5]Identified as hospital 2002-37 in Appendix B.

AMOUNTS AVAILABLE FOR PAYMENTS AFTER AUDIT ADJUSTMENTS

After applying the audit adjustments, the amounts available for UPL payments to hospitals were reduced to $22,605,972 for SFY 2001 and $132,742,842 for SFY 2002:

Table 2: Amounts Available for UPL Payments

	SFY 2001	SFY 2002
Indiana's calculations	$24,764,333	$137,059,740
Less audit adjustments	2,158,361	4,316,898
Available for UPL Payments	**$22,605,972**	**$132,742,842**

The calculations of the amounts available covered 40 hospitals each year.

UNALLOWABLE PAYMENTS TO HOSPITALS

Indiana made UPL payments totaling $22,687,824 to 37 hospitals for SFY 2001 and $131,495,346 to 39 hospitals for SFY 2002.[6] These payments exceeded the individual hospitals' amounts available for UPL payment by $2,074,133 and $3,040,569 for SFYs 2001 and 2002, respectively. (See Table 3 for details.) Because the State plan effectively imposed a hospital-specific limit on the payments, any payment to an individual hospital in excess of the amount of the UPL that was specifically attributable to the individual hospital was unallowable for Federal reimbursement. These unallowable payments amounted to $5,114,702 ($3,173,161 Federal share).

Table 3: Calculation of Unallowable UPL Payments*

	SFY 2001	SFY 2002
Available for UPL payments (after audit adjustments)	$22,605,972	$132,742,842
Less amounts for hospitals not receiving payments	1,992,281	4,288,065
Balance available for hospitals receiving payments	$20,613,691	$128,454,777
UPL payments made	22,687,824	131,495,346
Unallowable UPL payments	**$2,074,133**	**$3,040,569**

*See Appendixes A and B for the amounts by hospital.

For the 2-year period, the unallowable UPL payments totaled $5,114,702 ($3,173,161 Federal share).

[6]Although included in Indiana's calculations of the total amounts available for UPL payments, some non-State government hospitals did not receive SFY 2001 or 2002 UPL payments.

RECOMMENDATIONS

We recommend that Indiana:

- refund $3,173,161 to the Federal Government and

- revise its UPL methodology to exclude unpaid Medicaid claims from the calculations.

STATE'S COMMENTS

In written comments on the draft report, Indiana disagreed with our position concerning unpaid claims and did not address its use of an incorrect cost-to-charge ratio or the overstatement of graduate medical education expenses. Indiana stated that Federal regulations and the State plan supported the inclusion of Medicaid unpaid days in the UPL calculations and concluded that it should not be required to refund the $3,173,161 Federal share.

Indiana presented five reasons to support its position:

1. Indiana said that Federal regulations allowed States to establish UPLs based on reasonable estimates of the amounts that Medicare would pay for allowable Medicaid services. Accordingly, Indiana believed that its UPL calculation should include all Medicaid services, regardless of the level of Medicaid reimbursement, as long as Medicare would pay for the services using Medicare payment principles.

2. Indiana referred to legal decisions involving the Medicare DSH program that ultimately resulted in a Federal ruling whereby all Medicaid-eligible inpatient days are to be included as Medicaid days in Medicare DSH calculations, regardless of whether Medicaid paid for the services.

3. According to Indiana, CMS permitted the inclusion of Medicaid-eligible, but unpaid, claims in Indiana's UPL calculation by requesting a UPL demonstration that included unpaid claims and subsequently approving the State plan amendment.

4. Indiana asserted that the State plan, Attachment 4.19A, page 17 did not require Medicaid to pay for services in order to be included in the State plan's definition of "services." Indiana said that such services needed only to be reimbursable under the Medicaid program. Indiana also "concluded it is reasonable that Medicare payment principles would consider the services in question as fully reimbursable because Medicare would reimburse for such services filed within approximately two years of the date of service."

5. According to Indiana, all claims included in the UPL calculation were processed through Indiana's claims processing system and, as such, were scrutinized to ensure that only Medicaid-covered services were included.

We have included the State's comments in their entirety as Appendix C.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

Our responses to Indiana's five points follow:

1. Indiana's UPL calculations were contrary to Attachments 4.19A and 4.19B of the State plan, which states that hospitals may receive UPL payments equal to the difference between Medicaid payments to the hospital and a reasonable estimate of the amount that Medicare would have been paid for the same services. Because the time limits for filing the claims had expired, the services did not qualify for Medicaid payment.

2. Medicare legal decisions and the Medicare policies based on those decisions should not be interpreted as applicable to Medicaid. In addition, the decisions involved unrelated issues.

3. We contacted CMS officials who were unable to confirm that they had received the "UPL demonstration" material from Indiana. The officials stated that they were unaware of the inclusion of unpaid claims in Indiana's UPL calculations.

4. We do not dispute Indiana's position that the unpaid claims may have been Medicaid reimbursable if the claims had been filed within the time limits required by Indiana Code. Similarly, we do not assert that the services, if otherwise provided to Medicare beneficiaries under the Medicare program, would not have been Medicare reimbursable. The services, however, did not qualify for Medicaid payment, and because Medicaid did not pay the hospitals, the inclusion of the services in the UPL calculations was inconsistent with State plan Attachments 4.19A and 4.19B. We do not agree that nonexistent payments (for unpaid claims) can reasonably be construed as "Medicaid payments to the hospital . . . for services provided by the hospital" as required by the State plan.

5. We acknowledge that we did not assess whether the unpaid Medicaid claims would have been otherwise allowable had they been filed on a timely basis and been subjected to full Medicaid claims processing screening. As stated above, we determined that the claims did not meet the State's 1-year Medicaid filing limit and therefore did not qualify for payment under Indiana Code.

We continue to believe that the State's Medicaid UPL calculations should not include Medicaid unpaid claims. Under Indiana's rationale, the inclusion of unpaid claims in the UPL calculations would effectively circumvent the State's 1-year Medicaid claim filing requirement for those hospitals receiving UPL payments.

APPENDIXES

UNALLOWABLE PAYMENTS TO NON-STATE GOVERNMENT HOSPITALS FOR SFY 2001

	Upper-Payment-Limit (UPL) Payments Made	Available for UPL Payments*	Unallowable Payments
Hospitals receiving UPL payments:			
2001 – 1	$41,158	$19,880	$21,278
2001 – 2	132,303	126,715	5,588
2001 – 3	2,007,836	1,839,281	168,555
2001 – 4	1,678,651	1,616,462	62,189
2001 – 5	565,834	531,945	33,889
2001 – 6	342,568	324,443	18,125
2001 – 7	347,669	339,660	8,009
2001 – 8	401,637	393,503	8,134
2001 – 9	1,383,807	1,344,498	39,309
2001 – 10	739,367	699,065	40,302
2001 – 11	139,217	131,763	7,454
2001 – 12	370,774	352,441	18,333
2001 – 13	313,901	312,077	1,824
2001 – 14	630,557	624,266	6,291
2001 – 15	678,014	640,129	37,885
2001 – 16	177,271	174,583	2,688
2001 – 17	132,670	119,658	13,012
2001 – 18	212,707	205,275	7,432
2001 – 19	615,695	573,538	42,157
2001 – 20	557,567	539,177	18,390
2001 – 21	513,120	504,146	8,974
2001 – 22	552,210	517,205	35,005
2001 – 23	544,147	519,243	24,904
2001 – 24	267,928	236,494	31,434
2001 – 25	1,051,708	1,009,289	42,419
2001 – 26	29,301	26,417	2,884
2001 – 27	226,609	215,512	11,097
2001 – 28	540,878	515,260	25,618
2001 – 29	116,376	95,485	20,891
2001 – 30	432,746	352,795	79,951
2001 – 31	178,878	162,826	16,052
2001 – 32	297,601	278,217	19,384
2001 – 33	117,337	100,979	16,358
2001 – 34	215,907	208,033	7,874
2001 – 35	5,703,928	4,546,616	1,157,312
2001 – 36	244,412	233,640	10,772
2001 – 37	185,535	183,175	2,360
	$22,687,824	**$20,613,691**	**$2,074,133**
Hospitals not receiving UPL payments:			
2001 – 38		653,763	
2001 – 39		489,612	
2001 – 40		848,906	
		$22,605,972	
Federal share of unallowable payments			**$1,286,792**

*Amounts available for UPL payments after audit adjustments.

UNALLOWABLE PAYMENTS TO NON-STATE GOVERNMENT HOSPITALS FOR SFY 2002

	Upper-Payment-Limit (UPL) Payments Made	Available for UPL Payments*	Unallowable Payments
Hospitals receiving UPL payments:			
2002 – 1	$150,307	$141,716	$8,591
2002 – 2	545,462	539,247	6,215
2002 – 3	9,630,160	9,035,981	594,179
2002 – 4	7,195,683	7,015,203	180,480
2002 – 5	2,868,791	2,866,630	2,161
2002 – 6	3,876,546	3,514,581	361,965
2002 – 7	1,409,153	1,383,847	25,306
2002 – 8	1,742,898	1,730,010	12,888
2002 – 9	1,892,034	1,892,034	-
2002 – 10	5,793,207	5,782,253	10,954
2002 – 11	4,860,628	4,747,034	113,594
2002 – 12	776,660	760,712	15,948
2002 – 13	1,734,875	1,705,604	29,271
2002 – 14	1,324,223	1,318,236	5,987
2002 – 15	2,636,910	2,621,126	15,784
2002 – 16	2,737,125	2,624,462	112,663
2002 – 17	3,980,566	3,969,966	10,600
2002 – 18	651,337	563,105	88,232
2002 – 19	877,625	829,764	47,861
2002 – 20	2,597,499	2,458,441	139,058
2002 – 21	2,676,589	2,653,676	22,913
2002 – 22	2,159,060	2,131,421	27,639
2002 – 23	2,236,223	2,198,391	37,832
2002 – 24	2,375,107	2,338,287	36,820
2002 – 25	1,013,317	1,000,316	13,001
2002 – 26	4,621,267	4,543,273	77,994
2002 – 27	504,296	502,644	1,652
2002 – 28	1,186,913	1,090,734	96,179
2002 – 29	2,332,117	2,160,549	171,568
2002 – 30	557,643	514,734	42,909
2002 – 31	2,377,147	2,358,862	18,285
2002 – 32	1,574,634	1,533,436	41,198
2002 – 33	737,786	720,848	16,938
2002 – 34	1,166,814	1,116,678	50,136
2002 – 35	1,073,084	1,067,313	5,771
2002 – 36	1,132,888	1,120,469	12,419
2002 – 37	44,623,277	44,049,599	573,678
2002 – 38	955,636	947,420	8,216
2002 – 39	909,859	906,175	3,684
	$131,495,346	**$128,454,777**	**$3,040,569**
Hospitals not receiving UPL payments:			
2002 – 40		4,288,065	
		$132,742,842	
Federal share of unallowable payments			**$1,886,369**

*Amounts available for UPL payments after audit adjustments.

"People helping people help themselves"

Mitchell E. Daniels, Jr., Governor
State of Indiana

Indiana Family and Social Services Administration
402 W. WASHINGTON STREET, P.O. BOX 7083
INDIANAPOLIS, IN 46207-7083

E. Mitchell Roob Jr., Secretary

March 4, 2005

Mr. Paul Swanson
Regional Inspector General for Audit Services
Office of Audit Services
Department of Health and Human Services
233 North Michigan Avenue, Suite 1360
Chicago, Illinois 60601

Dear Mr. Swanson:

Please consider this our formal response to the January 25, 2005 draft report, A-05-03-00068, entitled "Review of Indiana's Medicaid Upper Payment Limits for State Fiscal Years 2001 and 2002." The report stated the objectives of the Office of Inspector General's ("OIG's") audit:

[W] ere to determine whether Indiana:

- calculated the UPL for non-State government hospitals in accordance with Federal regulations and the approved State plan amendment and properly included UPL payments in the calculation of hospital-specific DSH limits and

- calculated the UPL for non-state government nursing homes in accordance with Federal regulations and the approved State plan amendment.

The OIG found that the State of Indiana had overstated the Upper Payment Limit ("UPL") for non-State government hospitals by approximately $2.2 million for State Fiscal Year ("SFY") 2001 and by approximately $4.3 million for SFY 2002. The majority of these amounts were due to the fact that the calculation of the UPL included Indiana Medicaid claims for which the Medicaid payment was zero. These claims received a payment of zero from Indiana Medicaid because they were not submitted in a timely manner according to the Indiana Administrative Code ("IAC"), even though payment of these claims is fully permitted by Medicare payment principles. The report also includes a finding that the SFYs 2001 and 2002 Indiana Municipal Hospital Payment Adjustments were overstated. Therefore, the OIG report recommends that the State of Indiana refund $3,173,161 to the Federal Government.

We do not agree with the OIG's interpretation of Indiana's UPL methodology whereby the OIG believes that Indiana should exclude unpaid Medicaid days from either its aggregate UPL calculation or the calculation of the Indiana Medicaid Municipal Payment Adjustment. Below we have discussed the reasons why we believe that federal regulations and Indiana's Medicaid State Plan support the inclusion of Medicaid unpaid days in both of these calculations, including that: (1) Federal regulations pertaining to inpatient hospital UPLs permit a state to set its UPL at a **reasonable** estimate of the amount that would be paid under Medicare payment principles ; (2) Case law concerning Medicare DSH calculations clearly state that unpaid Medicaid days must be included in Medicare DSH calculations; (3) the Centers for Medicare and Medicaid Services ("CMS") specifically approved the inclusion of Medicaid unpaid services in Indiana's UPL calculation when it approved Indiana's Municipal Hospital Payment Adjustment State Plan Amendment; (4) Indiana's Medicaid State Plan, Attachment 4.19A, Page 17, clearly defines Medicaid services as including inpatient services that are reimbursable, rather than reimbursed, under Indiana's Medicaid program; and (5) Indiana's claim processing system results in only Medicaid services covered by the Indiana Medicaid State Plan being included in Indiana's UPL and Municipal Hospital Payment Adjustment calculation, as allowed by federal regulation and the Indiana State Plan.

One objective of the OIG's audit was to determine whether Indiana calculated the UPL for non-State governmental hospitals in accordance with federal regulations. It is our understanding that Table 1, Audit Adjustments, represents the amount that the OIG believes the Indiana Non-State Government Owned or Operated UPL findings have been overstated (stated in terms of federal dollars). This table indicates that an audit adjustment of approximately $2.1 million for SFY 2001 and $4.5 million for SFY 2002 is recommended due to the inclusion of "non-paid" claims.

There is nothing in federal regulation that indicates that any Medicaid service furnished by providers is excluded from the UPL based on the Medicaid payment level for such service. Federal regulations provide States with the ability to make reasonable estimates of the amounts that would be paid under Medicare to determine its UPL and provide States with flexibility to develop procedures for applying the UPL test. The UPL calculation is guided by federal regulations at 42 CFR 447.272 and 447.321. The federal regulations at 42 CFR 447.272 -- "Inpatient services: Application of upper payment limits", define the UPL as "a reasonable estimate of the amount that would be paid for the services furnished by the group of facilities under Medicare payment principles." The Office of Medicaid Policy and Planning ("OMPP") believes that this definition would allow all Medicaid services to be included in its UPL calculation, regardless of the level of Medicaid reimbursement so long as Medicare would pay for the service using Medicare payment principles. More specifically, a claim submitted to Medicare within its filing deadline of approximately 2 years after the date of service would be reimbursed under Medicare payment principles.

In determining whether Medicare and Medicaid laws include unpaid inpatient services in the calculation of its UPL, the OMPP looks to how unpaid days are considered in other Medicare and Medicaid programs, including the Medicare DSH program. CMS mandates the inclusion of unpaid Medicaid days in calculating a hospital's disproportionate patient percentage. This is

used to determine the level of the DSH payment portion of the Medicare Prospective Payment System. In 1986, the Department of Health and Human Services ("HHS"), Health Care Financing Administration (now known as CMS) changed, by regulation, how the disproportionate patient percentage under the Medicare DSH program would be determined, to exclude unpaid Medicaid days. Court cases followed in which the courts ruled that Medicaid days did not have to be paid by Medicaid in order to be included in the DSH calculation. Instead, the only requirement was that the Medicaid days were eligible or qualified for Medicaid reimbursement in order to be included in the calculation for DSH purposes. Thereafter, CMS changed its regulations to comply with the court decisions. In February 1997, the then-Secretary of HHS issued a ruling that mandated that in calculating the disproportionate patient percentage, the Medicaid numerator must include all inpatient days of patients who were eligible for Medicaid "whether or not the hospital received payment for those inpatient hospital services." See *Jewish Hospital v. Secretary of HHS,* 19 F3d 270 (6th Cir. 1994); *Cabell Huntington Hospital, Inc. v. Shalala,* 101 F3d 984 (4th Cir. 1996); *Legacy Emanuel Hosp & Health Ctr v. Shalala,* 97 F3d 1261 (9th Cir. 1996); *Deaconess Health Services Corp v. Shalala,* 83 F3d 1041 (8th Cir. 1996); and 63 F.R. 40954, 40985 (July 31, 1998).

CMS has permitted Medicaid eligible but unpaid claims to be used in Indiana's calculation of the UPL. This has been confirmed by the CMS through the State Plan Amendment (SPA) approval process. It has been CMS's practice to request a UPL demonstration that must meet its requirements before a SPA will be approved. The Indiana UPL was approved by CMS through this process. The UPL demonstration approved by CMS included Schedule 13, "Medicaid Zero Paid Claims" in which it was clearly shown that these claims were included in the calculation.

The OIG's determination for the exclusion of "non-paid" claims in the calculation of the UPL is based upon an interpretation of Attachment 4.19A, Page 17, III (1) of the Indiana Medicaid State Plan. The Indiana Medicaid State Plan provision indicates that a non-State governmental hospital may receive a payment adjustment in an amount:

...equal to the difference between:

(a) The amount of Medicaid payments to the hospital made pursuant to the Medicaid reimbursement provisions under Article 15 of the Indiana Code, excluding DSH payments made pursuant to Indiana Code 12-15-16 and 12-15-19, for **services** [emphasis added] provided by the hospital during the state fiscal year; and

(b) An amount equal to the lesser of the following:
   (i) the hospital's customary charges for the services described in (a) above; or
   (ii) a reasonable estimate by the Office of the amount that would have been paid for those **services** [emphasis added] under Medicare payment principles.

The OIG report defines "the services" in (b)(i) and "those services" in (b)(ii) as only those services that received a Medicaid payment. As a result, OIG concluded that Medicaid claims that received a zero payment were to be excluded in the payment calculation.

The OMPP disagrees with this narrow interpretation of "services" covered by the Indiana Medicaid State Plan. The correct interpretation is to consider that "the services" in (b)(i) and "those services" in (b)(ii) refer to "the Medicaid reimbursement provisions under Article 15 [Medicaid] of the Indiana Code." Such services include all Medicaid "services provided by the hospital during the state fiscal year" (see a above). In fact, "Medicaid services" is specifically defined in the Municipal Hospital Payment Adjustments section of the Indiana Medicaid State Plan to include "those inpatient services provided by a Municipal Hospital that are **reimbursable** under the Medicaid program." (Emphasis added). See Indiana Medicaid State Plan, Attachment 4.19A, Page 17. This section does not state that in order to be included within Indiana's Medicaid State Plan "services" definition, Medicaid must make payments for the services, only that such services be "reimbursable under the Medicaid program." Clearly, the unpaid services included in both the UPL and the calculation of the Municipal Hospital Payment Adjustment are reimbursable under the Medicaid program.

Further, even though the calculation of the Municipal Hospital Payment Adjustment in the Indiana Medicaid State Plan specifically includes all services included in the Medicaid program, the OIG instead points to an IAC provision detailing when regular Medicaid claims payments will be made. This section of the IAC applies to claims payments, not supplemental payments such as the Municipal Hospital Payments. The OIG references this IAC provision as proof that Indiana does not make Medicaid payments for Medicaid claims filed after the Medicaid twelve-month filing deadline and that such services should not be included in either the UPL calculation or the Municipal Hospital Payment Adjustment. IAC 1-1-3 states that, "All provider claims for payment for services rendered to recipients must be originally filed with the Medicaid contractor within twelve (12) months of the date of the provision of service." And further, that "all claims filed after twelve (12) months of the date of the provision of the service...shall be rejected for payment unless a waiver has been granted." However, the Indiana Medicaid State Plan's Municipal Hospital Payment Adjustment calculation does not look to whether a claim has been made in accordance with the IAC's timely filing provisions, but specifically looks to whether Medicaid services would be reimbursable under the Indiana Code. Thus, for purposes of calculating the Municipal Hospital Payment Adjustment, OMPP looks to the definition of Medicaid services included under Indiana Code 12-15-15-1, which includes "inpatient hospital services." OMPP believes that it is reasonable to believe that the fact that inpatient hospital claims for services provided to Medicaid recipients were filed after the filing deadline and paid zero dollars does not preclude the services from being included for purposes of determining the OMPP's reasonable estimate of the amount that would have been paid for those services under Medicare payment principles. After performing a detailed claim analysis, the OMPP has concluded it is reasonable that Medicare payment principles would consider the services in question as fully reimbursable because Medicare would reimburse for such services filed within approximately two years of the date of service and because Medicare DSH payment calculation

would require the inclusion of Medicaid unpaid days in the calculation of Medicare DSH payments.

The intent of the Indiana Medicaid State Plan was to provide for a Municipal Hospital Payment Adjustment that was consistent with Medicare and Medicaid reimbursement calculations, CMS policy, and the Medicaid UPL regulations. Thus, because Indiana has included Medicaid services provided by a hospital as the services that would be included in determining the UPL based on Medicare payment principles, Indiana believes that unpaid Medicaid services are also includable in its Municipal Hospital Payment Adjustment calculation.

All Medicaid claims included in Indiana's SFY 2001 and 2002 Medicaid UPL calculation and the calculation of the Municipal Hospital Payment Adjustments were processed through the federally-certified Indiana*AIM* and MMIS (Medicaid Management Information System) system. This system identifies whether or not a service on a submitted claim is an Indiana Medicaid service. If a claim is submitted that includes a non-Medicaid service, it is denoted by one of several codes that identify it as a service not covered under Indiana Medicaid. There are a number of valid reasons why claims will be denied because they are not for Medicaid covered services. For example, error code 4032 indicates that the procedure code is not on file, therefore not covered under Indiana Medicaid. Other error codes identify claims for which the service was covered at one time, but not at the time of service, or may be covered under some Medicaid packages, but not by the one for which the patient is eligible. All claims included in the Indiana Medicaid UPL calculation and Municipal Hospital Payment Adjustment were scrutinized to ensure that only Medicaid covered services under the State Plan were included.

For the above reasons, the OIG's interpretation of the language of the Indiana State Plan is in error, and the finding, as well as the resulting request for repayment of federal funds, should be removed when preparing the final report.

If you have any questions concerning this letter, please contact Pat Nolting at 317-232-4318.

Sincerely,

E. Mitchell Roob Jr.
Secretary