

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE PAYMENTS  
FOR BENEFICIARIES WITH  
INSTITUTIONAL STATUS**

**PACIFICARE OF CALIFORNIA  
SANTA ANA, CALIFORNIA**



**JUNE GIBBS BROWN**  
**Inspector General**

**APRIL 1998**  
**A-05-97-00013**

# *Office of Inspector General*

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**DEPARTMENT OF HEALTH AND HUMAN SERVICES**

**REGION V  
105 W. ADAMS ST.**

**CHICAGO, ILLINOIS 60603-6201**

**April 27, 1998**

**OFFICE OF  
INSPECTOR GENERAL**

Common Identification Number: A-05-97-00013

Debra Logan, Corporate Director  
PacifiCare of California  
3120 West Lake Center Drive  
Santa Ana, CA 92799-5186

Dear Ms. Logan:

This final report provides the results of our audit entitled, "Review of Medicare Payments for Beneficiaries with Institutional Status." Our objective was to determine if capitation payments to PacifiCare of California, under Medicare risk contract H0543, were appropriate for beneficiaries reported as institutionalized.

We determined PacifiCare received Medicare overpayments totaling \$9,700 for 14 beneficiaries incorrectly classified as institutionalized. The 14 beneficiaries were part of a statistical sample of 100 Medicare beneficiaries reported as institutionalized during the period October 1, 1994 through September 30, 1996. Based on our sample results, we estimate that PacifiCare received Medicare overpayments of at least \$398,084 for beneficiaries incorrectly classified as institutionalized during the audit period.

## **INTRODUCTION**

### **BACKGROUND**

PacifiCare participates as a Medicare risk-based health maintenance organization (HMO) through contract H0543. An HMO is a legal entity that provides or arranges for basic health services for its enrolled members. An HMO can contract with the Health Care Financing Administration (HCFA) to provide medical services to Medicare beneficiaries. Medicare beneficiaries enrolled in HMOs receive all services covered by Parts A and B of the program.

Under risk-based contracts, HCFA makes monthly advance payments to HMOs at the per capita rate set for each enrolled beneficiary. The rates are set at 95 percent of the expected fee-for-service costs that would have been incurred by Medicare had beneficiaries not enrolled in HMOs.

A higher capitation rate is paid for risk-based HMO enrollees who are institutionalized. Requirements for institutional status are met if a Medicare beneficiary has been a resident of a nursing home, sanatorium, rest home, convalescent home, long-term care hospital or domiciliary home for a minimum of 30 consecutive days immediately prior to the first day of the current reporting month. Risk contract HMOs are required to submit to HCFA each month a list of enrollees meeting the institutional status requirements. The advance payments received by HMOs each month are subsequently adjusted to reflect the enhanced

reimbursement for institutional status. For example, during 1995 HMOs received a monthly advance payment of \$694 for each non-Medicaid male beneficiary, 85 years of age or older, residing in a non-institutional setting in Los Angeles County, California. The Medicare payment to HMOs for a similar beneficiary living in an institutional setting was \$1,209. The monthly advance payment of \$694 would have been adjusted to \$1,209 after the beneficiary was reported to HCFA as having institutional status.

## **SCOPE OF AUDIT**

Our audit was performed in accordance with generally accepted government auditing standards. The objective was to determine if capitation payments to PacifiCare were appropriate for beneficiaries reported as institutionalized. We also conducted a review of PacifiCare's internal controls, focusing on procedures for verifying the institutional status of Medicare beneficiaries. The audit covered the period October 1, 1994 through September 30, 1996.

A simple random sample of 100 was selected from a universe of 10,393 Medicare beneficiaries reported as institutionalized by PacifiCare during the audit period. From PacifiCare, we obtained the names and addresses of the institutions in which the beneficiaries in the sample resided. Confirmation letters were sent to institutional facilities to verify that the sample beneficiaries were institutionalized for the periods PacifiCare reported to HCFA. Based on responses received from institutional facilities, we identified Medicare beneficiaries who were incorrectly reported as having institutional status. For each incorrectly reported beneficiary, we calculated the Medicare overpayment by subtracting the non-institutional payment that PacifiCare should have received from the institutional payment actually received.

Using the overpayments identified in our sample, we projected the probable value of Medicare overpayments in the universe of beneficiaries. Details of our statistical sample and projection are shown on Appendix A.

Our field work was performed from February through September 1997 at PacifiCare offices in Cypress, California; HCFA offices in San Francisco, California; and our field office in Columbus, Ohio.

## **RESULTS OF AUDIT**

PacifiCare received Medicare overpayments totaling \$9,700 for 14 beneficiaries incorrectly classified as institutionalized. The 14 beneficiaries were part of a statistical sample of 100 Medicare beneficiaries reported as institutionalized during the period October 1, 1994 through September 30, 1996. Based on our sample results, we estimate that PacifiCare received Medicare overpayments of at least \$398,084 for beneficiaries incorrectly classified as institutionalized during the audit period.

## **MEDICARE OVERPAYMENTS**

Our review of PacifiCare records indicated that the majority of the Medicare overpayments occurred for the following reasons.

- PacifiCare's internal control system had previously identified a number of the Medicare overpayments discovered during our review. Documentation was provided by PacifiCare indicating that adjustments had been submitted to HCFA to reverse the incorrect institutional payments. However, the adjustments were not processed by HCFA.
- For several beneficiaries, incorrect discharge dates provided by the institutional facilities to PacifiCare resulted in unallowable claims.
- For other beneficiaries, clerical errors resulted in the incorrect reporting of beneficiaries as institutionalized. PacifiCare uses a contractor to electronically submit the monthly list of institutionalized beneficiaries to HCFA. PacifiCare indicated that the beneficiaries in question did not appear on the list of institutional beneficiaries provided to the contractor. However, the beneficiaries do appear on the list of institutional beneficiaries submitted to HCFA by the contractor.

In addition to the primary causes noted above, one beneficiary was identified as living in a retirement community that did not meet institutional status requirements. Another beneficiary was improperly claimed when PacifiCare incorrectly applied a HCFA rule that allows beneficiaries to leave institutional facilities, without losing institutional status, for a hospital visit of 15 days or less.

## **INTERNAL CONTROLS**

Except for reporting errors involving a contractor, the internal controls used by PacifiCare are generally adequate in verifying and reporting the institutional residency of the Medicare beneficiaries enrolled in the HMO. PacifiCare internal controls require that all institutional facilities be contacted each month by mail or telephone to verify beneficiary status prior to submitting the monthly list of institutionalized members to HCFA. PacifiCare mails a listing of Medicare beneficiaries to the institutional facilities by the 5<sup>th</sup> day of each month. The list each institutional facility receives includes all HMO members PacifiCare believes are residents of that institutional facility. The institutional facility is asked if any of the beneficiaries on the list were discharged and if any Medicare eligible PacifiCare members have recently become residents of the facility. The institutional facility is instructed to return the completed list to PacifiCare by the 20<sup>th</sup> of the month. Institutional facilities that do not return the list of beneficiaries are contacted by telephone and asked to verify the residency of the PacifiCare members. A listing of beneficiaries who meet the institutional status requirements is forwarded to a contractor who electronically submits the Medicare claims to HCFA.

In addition, each month PacifiCare conducts a retroactive review of beneficiaries who were previously claimed as institutional. The beneficiary discharge data obtained in the current month from the institutional facilities is matched against the lists of institutional beneficiaries submitted to HCFA in the past. This process identifies beneficiaries who were discharged from the institutional facilities in the previous month after the listings of beneficiaries had been returned to PacifiCare. The process also identifies instances where the institutional facilities provided PacifiCare incorrect discharge data in one month and correct data in a later month. For all Medicare overpayments identified through the retroactive review, PacifiCare submits adjustments to HCFA to reverse the incorrect institutional payments.

## **RECOMMENDATIONS**

We recommend that PacifiCare:

- Refund the specific overpayments identified through our review totaling \$9,700.
- Review the balance of the institutionalized beneficiary universe to identify and refund additional overpayments, which we estimate to be at least \$398,084.

## **AUDITEE COMMENTS**

In a letter dated March 20, 1998, Konwiecki & Rank, Attorneys at Law, responded to our draft report on behalf of PacifiCare. The response is included with this report as Appendix B. During our audit, we identified 16 beneficiaries who were incorrectly classified as institutionalized. In the response to our draft audit report, PacifiCare provided additional information supporting the institutional residency for two of the beneficiaries. PacifiCare officials agreed that the remaining 14 beneficiaries were incorrectly reported to HCFA as institutionalized and that Medicare overpayments had resulted.

PacifiCare also indicated that they had previously identified and corrected the problems that resulted in reporting errors by the contractor. Therefore, PacifiCare did not agree with our recommendation to strengthen internal controls involving the contractor.

## **OIG RESPONSE**

Based on the additional information provided by PacifiCare, we were able to verify the institutional status of two beneficiaries. Our report has been adjusted to reflect that 14 beneficiaries, rather than 16, were incorrectly classified as institutionalized during our audit period. In addition, we removed the recommendation that PacifiCare strengthen internal controls to ensure that contractor errors do not occur in the future. Using the information provided by PacifiCare staff, combined with data compiled during the audit, we were able to conclude that changes to PacifiCare's internal controls were not necessary at this time.

We continue to recommend that PacifiCare refund the overpayments identified through our review totaling \$9,700 and review the balance of the institutionalized beneficiary universe to identify and refund additional overpayments, which we estimate to be at least \$398,084. Once all overpayments in the universe are identified, PacifiCare should submit adjustments to HCFA and verify that the adjustments are correctly processed by HCFA.

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Final determination as to actions taken on all matters reported will be made by the U. S. Department of Health and Human Services (HHS) action official named below. 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 (Public Law 90-23). Office of Inspector General, Office of Audit Services reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act that the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to Common Identification Number A-05-97-00013 in all correspondence relating to this report.

Sincerely yours,



Paul Swanson  
Regional Inspector General  
for Audit Services

**Direct Reply to HHS Action Official:**

Director, Office of Managed Care  
33-02-01  
7500 Security Boulevard  
Baltimore, Maryland 21244-1850

**PACIFICARE OF CALIFORNIA****VARIABLE APPRAISAL OF STATISTICAL SAMPLE**

|                         |         |
|-------------------------|---------|
| Universe:               | 10,393  |
| Sample Size:            | 100     |
| Nonzero Items:          | 14      |
| Value of Nonzero Items: | \$9,700 |

|                     |             |
|---------------------|-------------|
| Mean:               | 97.00       |
| Standard Deviation: | 355.24      |
| Standard Error:     | 35.35       |
| Skewness:           | 6.31        |
| Kurtosis:           | 50.35       |
| Point Estimate:     | \$1,008,141 |

## Projection at the 90 Percent Confidence Level:

|                    |             |
|--------------------|-------------|
| Lower Limit:       | \$398,084   |
| Upper Limit:       | \$1,618,197 |
| Precision Amount:  | \$610,057   |
| Precision Percent: | 60.51%      |

**KONOWIECKI & RANK**

APPENDIX B

ATTORNEYS AT LAW  
A PARTNERSHIP INCLUDING A PROFESSIONAL CORPORATION  
633 WEST FIFTH STREET, SUITE 3500  
LOS ANGELES, CALIFORNIA 90071-2007  
TELEPHONE (213) 229-0890  
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RONAN COHEN

March 20, 1998

**VIA FACSIMILE (614) 469-2518  
AND FEDERAL EXPRESS**

Mr. John Hagg  
HHS/OIG Office of Audit Services  
Two Nationwide Plaza, Suite 710  
280 North High Street  
Columbus, Ohio 43215

Re: *Response to Draft Audit Review of Medicare  
Payments for Beneficiaries with Institutionalized  
Status (DN-05-97-00013)*

Dear Mr. Hagg:

We represent PacifiCare with respect to the above-referenced item. On January 20, 1998, your office submitted a draft audit report (the "Report") to PacifiCare of California ("PacifiCare") outlining your "Review of Medicare Payments for Beneficiaries with Institutionalized Status" (CIN A-05-97-00013). In the Report, the auditors requested that PacifiCare respond to their findings. As confirmed in our letter dated February 12, 1998, the auditors granted PacifiCare an extension until March 20, 1998, to respond to the Report.

The auditors randomly selected 100 Medicare beneficiaries who were identified as having been institutionalized at some time during the two-year period from October 1, 1994, through September 30, 1996, and from those 100 members, the auditors identified 16 member and 23 member-months during which the auditors determined PacifiCare was paid as if the member were institutionalized when the members did not meet the qualifications for institutional status.

The Report identifies five types of errors. We outline each of the categories and following each description we provide PacifiCare's response.

Mr. John Hagg  
March 20, 1998  
Page 2

**1. Failure to Process Retrospective Adjustments to Overpayments.  
(Auditors note 6 cases. PacifiCare notes 9 cases).**

PacifiCare is required to report the institutionalized status of a member to the Health Care Financing Administration ("HCFA") prior to end of the month in question. Accordingly, some members who are in institutions at the time of reporting are reported as eligible for institutionalized status, even though they may leave the institution prior to the end of the month and therefore lose their eligibility. In order to correct the overbilling which can occur, PacifiCare, in response to a directive from HCFA in policy letter from RO IX, developed a retrospective review overbilling control system in 1994, in which PacifiCare retrospectively reviews its institutional members and reports as "overbilled" any cases which PacifiCare determines would not have qualified. The auditors identified six cases in which PacifiCare properly reported a member as overbilled upon retrospective review, but which remain overbilled because HCFA has not yet properly adjusted payment.

In addition to the six members the auditors identified, PacifiCare has confirmed that three more members of the 16 identified as overbilled in the audit properly fall into this category. PacifiCare does not dispute that an overpayment occurred with these nine members in this sample, or that it may have been over-paid for some extrapolated number of members relating to the entire institutionalized population. However, PacifiCare believes that the appropriate method for adjusting payment is for HCFA to adjust the payment for each member for the appropriate month. If any other method is used to resolve the overpayment, then the status of each member will never be corrected. This will create irreconcilable errors when future adjustments are made to these payments.<sup>1</sup> In sum, PacifiCare believes that this is a HCFA procedural issue, which should be corrected by HCFA based upon the information provided by PacifiCare. PacifiCare is willing to work with HCFA and the other contracting plans to achieve an automated process to more appropriately address these concerns.

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<sup>1</sup> For example, assume that PacifiCare accurately refunds the difference between the institutional rate cell and the standard rate cell for a member that HCFA has failed to properly process. Then assume that this member is retrospectively determined to qualify for the ESRD rate cell. (ESRD is typically a higher paying rate cell than the institutionalized rate cell.). HCFA would still have the member listed as institutionalized in its database. Thus, to account for the ESRD rate cell, HCFA would calculate the difference between the institutional rate cell to the ESRD rate cell and pay the plan the difference. But, this would not reflect the accurate rate differential because the plan would already have refunded the difference between the standard rate and the institutionalized rate. Moreover, since HCFA's system would never have been updated, there would be no way to ever identify that the plan has not been properly paid. Because of the high volume of retroactive adjustments to enrollment data, this scenario or a similar one with equally skewed results is statistically significant.

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P.4/7

Mr. John Hagg  
March 20, 1998  
Page 3

**2. Inconsistent Data provided by the Institutions.  
(Auditors note 4 cases. PacifiCare notes 3 cases).**

As noted in the Report, PacifiCare has a system in place to confirm the institutional status of a member each month by contacting the institution prior to designating a member to HCFA as institutionalized. The institution is expected to provide accurate information regarding the status of the member as well as accurate discharge dates. However, because non-contracting institutions have little or no incentive to accurately report this data, there is room for error. Based upon the records the auditors provided, there were four cases in which the institutions provided different discharge dates to the auditors than were originally provided to PacifiCare.

PacifiCare notes that PacifiCare's internal controls, as described in the Report, for confirming institutionalized status with the institutions require a time intensive process in which PacifiCare employees spend hours contacting institutions to verify institutional status each month. PacifiCare believes that these procedures are not only "generally adequate," but also extremely rigorous. PacifiCare has confirmed with the respective institutions that, in fact, PacifiCare's original designation as institutionalized was correct for two of the four members the auditors identified as overbilled. At the same time, PacifiCare has identified one other case, which should appropriately fall into this category. (See Note 5). We believe that these three remaining cases are statistically insignificant because institutions have no incentive to bias the data. Thus, the inaccuracies are as likely to decrease the length of stay in the institution as they are to increase the length of stay. Since the auditors sampled members for whom the institutionalized rate cell had been paid, they could only identify overpayments. However, since the data are unbiased, there are likely to be an equal number of underpayments. Moreover, to the extent PacifiCare has already identified overbilling errors of this sort in its retroactive review, PacifiCare has already correctly reported them. However, when PacifiCare identifies an underbilling, HCFA guidelines do not permit PacifiCare to report the underbilling. Thus, the reporting system is already significantly biased in favor of underbilling. PacifiCare will notify HCFA of the overpayment for the specific member-months identified as overbilled in the Report. However, for the reasons explained, PacifiCare does not believe it is reasonable to statistically extrapolate from this result to the entire institutionalized population.

**3. Clerical Error. (Auditors note 3 cases,  
PacifiCare notes 2 cases)**

In the Report and supporting documents, you note that three members (for one member-month each) were reported to HCFA as institutionalized as a result of a clerical error, or other error, relating to the electronic submission of data by PacifiCare to HCFA.

Mr. John Hagg  
March 20, 1998  
Page 4

1. In one of the cases, PacifiCare has identified that it has already reported the overpayment to HCFA, and therefore, this is one of the three additional members PacifiCare has recategorized under category one described above.

2. One of the two remaining cases involved a date error, which occurred during set up of a production cycle. As a result of a system date not being properly changed, members were rereported as institutionalized in December 1995, if they were institutionalized in June 1995. PacifiCare identified this error and corrected it by reporting to HCFA all incorrectly reported members as an overbilling. PacifiCare believes that the specific case identified by the auditors in the sample was also previously reported to HCFA, and therefore, properly belongs in category one; nonetheless PacifiCare will re-report this case as overbilled to HCFA.

3. The final case involved a system logic error which was identified three months after the implementation of the overbilling control system was implemented in August 1994. In December 1994, PacifiCare corrected this logic error prospectively and thus, eliminated this error. PacifiCare will report the identified cost as an overbilling to HCFA.

**4. Misapplied Rule Regarding 15 Day Leave Without First Qualifying As Institutional. (1 case)**

The auditors identified one member (for one member-month) that PacifiCare incorrectly categorized as institutionalized because of a misapplication of the rules. HCFA rules indicate that a qualifying institutionalized member who leaves a facility for up to 15 days for an inpatient stay can continue to qualify as institutionalized. However, a PacifiCare employee incorrectly applied this rule for a member who left and returned to an institution, but had not yet qualified as an institutionalized member. PacifiCare has reviewed its policies and determined that its existing policies correctly apply the rule. PacifiCare believes that this was an isolated misapplication, and it has addressed this issue through further training. PacifiCare will report this case to HCFA.

**5. Retirement Home Which Did Not Meet Institutionalized Status. (1 case)**

The Report identified one case in which the auditors claim the member was living in an institution on the relevant date, but who did not meet institutional status requirements. PacifiCare reviewed this case and determined that the error was related to information on discharge dates from a qualifying institution. Accordingly, PacifiCare has reclassified this case into category two described above.

Mr. John Hagg  
March 20, 1998  
Page 5

**6. Incorrect Reporting of Institutional Status.  
(2 cases)**

The documents, which the auditors provided to PacifiCare in support of the Report, identified two beneficiaries who were overbilled as institutionalized with no explanation. PacifiCare has determined that it had already properly reported these member-months to HCFA as overbilled; and therefore, these two cases belong in category one.

**Response to Auditors' Recommendations.**

As noted above, PacifiCare's review identified only three cases (identified in category three and four above) in which PacifiCare or PacifiCare's procedures resulted in an overbilling of an institutionalized member, which PacifiCare did not subsequently correct. These three cases resulted in an overbilling of three member months out of a total of up to 240 member-months reviewed by the auditors. (The auditors reviewed 100 members known to be institutionalized at some time during the two-year period. It was possible for each member to be institutionalized for up to 24 months). This means that PacifiCare's implementation of its own procedures correctly reported 237 out of 240 months, which is nearly 99% accurate. Moreover, this compliance level is developed from a sample, drawn from a universe of members who were known to be reported as institutionalized. PacifiCare has addressed the specific errors identified in the Report, however, PacifiCare believes that its 99% compliance is more than adequate to meet HCFA's compliance requirements, and does not agree with the auditor's recommendations to further "strengthen internal controls."

PacifiCare believes that the appropriate corrective action that should result from the Audit is for HCFA to make the retroactive adjustments to all of the overbilled members, which PacifiCare has already reported or which were identified in the Audit. If this were done, HCFA would recoup up to 50% of all the estimated overpayments projected by the auditors.

We welcome the opportunity to work with you to resolve any further questions that arise from your audit findings. We believe that the auditors conducted a very thorough audit and that as we have noted above PacifiCare has a 99% accuracy rate, and thus further investigation is unnecessary. In light of this, and notwithstanding that we believe that extrapolation from the audit findings as proposed by the auditors is unwarranted, we are willing to work toward a mutually satisfactory resolution of all the

Mr. John Hagg  
March 20, 1998  
Page 6

claims raised in the Report. Once you have reviewed our comments, please contact us at your earliest convenience. In the meantime, if you have any questions or require additional information, please do not hesitate to contact PacifiCare or me.

Sincerely,

KONOWIECKI & RANK



Ronan Cohen

cc Tina Manning  
Debra Logan