



DEC 22 2005

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Report Number: A-01-03-00009

Ms. Beth Waldman
Medicaid Director
Office of Medicaid
Executive Office of Health and Human Services
Commonwealth of Massachusetts
1 Ashburton Place, 11th Floor
Boston, MA 02108

Dear Ms. Waldman:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General, Office of Audit Services final report entitled "Review of the Methodology for Calculating the Upper Payment Limit for Inpatient Hospitals by the Massachusetts Office of Medicaid for State Fiscal Year 2003." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the 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, 5 U.S.C. 552, as amended by Public Law 104-231, Office of Inspector General, Office of Audit Services reports are made available to members of the public to the extent information contained therein is not subject to exemptions in the Act (See 45 CFR Part 5).

If you have any questions or comments about this report, please address them to Joseph Kwiatkowski of my staff at (617) 565-2701 or through e-mail at Joseph.Kwiatkowski@oig.hhs.gov. To facilitate identification, please refer to Report Number A-01-03-00009 in all correspondence relating to this report.

Sincerely yours,


Michael J. Armstrong
Regional Inspector General
For Audit Services

Page 2 of 2 – Ms. Beth Waldman

Direct Reply to HHS Action Officials:

Mr. Richard McGreal
Associate Regional Administrator
Centers for Medicare & Medicaid Services
Division of Medicaid and Children's Health
U.S. Department of Health and Human Services
JFK Federal Building, Room 2275
Boston, Massachusetts 02203

Enclosures – as stated

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF THE METHODOLOGY
FOR CALCULATING THE UPPER
PAYMENT LIMIT FOR INPATIENT
HOSPITALS BY THE
MASSACHUSETTS OFFICE OF
MEDICAID FOR STATE FISCAL YEAR
2003**



**Daniel R. Levinson
Inspector General**

**DECEMBER 2005
A-01-03-0009**

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

Effective March 13, 2001 and May 14, 2002, the Centers for Medicare & Medicaid Services (CMS) revised Medicaid's upper payment limit (UPL) regulations for nursing facilities and inpatient hospitals, respectively. The UPL is an estimate of the maximum amount that would be paid for Medicaid services under Medicare payment principles.

The revised regulations changed the manner in which States calculate the UPL for various categories of providers. Under 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 category of provider-private facilities, State facilities, and non-State government-owned facilities. The regulations also created transition periods in which eligible States were allowed to make payments up to the category-specific UPL plus the allowable excess (the portion of Medicaid payments that exceeded the UPL in the applicable base year). Federal funds are not available for Medicaid payments that exceed these limits.

Disproportionate Share Hospital Payments

Section 1923 of the Social Security Act (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, which is generally defined as the cost of uncompensated care. States must consider supplemental payments received on behalf of Medicaid and uninsured patients when calculating hospital-specific DSH payment limits.

OBJECTIVES

At CMS' request, we reviewed the Massachusetts Office of Medicaid (the State agency) UPL calculation for inpatient hospital services for state fiscal year (SFY) 2003. Our audit objectives were to determine whether the State agency's methodology to calculate the inpatient UPL for SFY 2003 was in accordance with the revised regulations issued by CMS and to determine if supplemental payments were included by the State agency when calculating DSH specific payment limits for SFY 2003.

Our review was based on the inpatient UPL calculation dated September 23, 2003¹.

FINDINGS

The State agency's methodology to calculate the inpatient UPL for SFY 2003 was not in complete accordance with the revised regulations issued by CMS. In this regard, the State agency did not include all hospital inpatient providers in the calculation or use the most accurate

¹ The State agency has not formally submitted the inpatient UPL calculation to CMS.

Medicaid claims payment data available as a basis for its UPL calculation. We found that these conditions were generally caused by a lack of certain data and clerical error. As a result, there is a risk that the State agency's inpatient UPL may be misstated and the State agency cannot provide reasonable assurances that the SFY 2003 inpatient UPL was not exceeded.

As required, the State agency did include supplemental payments when calculating DSH specific payment limits for SFY 2003.

RECOMMENDATIONS

We recommend that the State agency work with CMS to ensure that the SFY 2003 inpatient UPL calculation:

- includes all hospital inpatient providers, and
- uses the most accurate Medicaid payment data rather than estimates throughout the calculation.

Auditee Comments

The State agency agreed that regulation required that the UPL calculation include all hospital inpatient providers. The State agency updated its UPL calculation to include all in-state providers, but believes that excluding out-of-state providers presents a more conservative calculation. The State agency indicated that it is not required to use actual Medicaid paid claims data as the basis for calculating the UPL.

Office of Inspector General Response

We believe our recommendations are valid and the State agency should take action as appropriate. We noted that during our audit the State agreed to add out-of-state hospitals to its UPL calculation. We believe that a reasonable UPL would include data from all providers, regardless of their physical location. The State agency's contractor that developed their UPL calculation also made a similar recommendation to the State agency.

Further, we continue to believe that the State Agency should use the most accurate Medicaid paid claims data rather than estimates whenever available to ensure that the UPL calculation is reasonable in accordance with Medicaid regulations. The State agency's contractor that developed their UPL calculation also made a similar recommendation to the State agency.

TABLE OF CONTENTS

	Page
INTRODUCTION	1
BACKGROUND	1
OBJECTIVES, SCOPE AND METHODOLOGY	2
Objectives	2
Scope	2
Methodology	2
FINDINGS AND RECOMMENDATIONS	2
PROGRAM REQUIREMENTS	3
UPL CALCULATION	3
Inclusion of All Hospitals in UPL Calculation	3
Use of the Most Accurate Medicaid Payment Data	3
RECOMMENDATIONS	4
AUDITEE COMMENTS	4
OFFICE OF INSPECTOR GENERAL RESPONSE	4
APPENDIX – AUDITEE’S RESPONSE	

INTRODUCTION

BACKGROUND

Title XIX of the Social Security Act (the Act) authorizes federal grants to states for Medicaid programs that provide medical assistance to low-income families, elderly individuals and persons with disabilities. Each state Medicaid program is administered by the state in accordance with an approved state plan. While the state has considerable flexibility in designing its state plan and operating its Medicaid program, it must comply with applicable federal requirements.

Chapter 42 Code of Federal Regulations (CFR) part 447 requires that the aggregate Medicaid payments made to private, non-state-owned public and state-owned and operated hospitals not exceed the UPL. The UPL refers to a reasonable estimate of the amount that would have been paid for the services furnished by the group of facilities under Medicare payment principles.

Massachusetts State Plan Amendment 02-023¹ defines the UPL as the level below which it is determined that the hospital reimbursement methodology will result in payments for hospital services that are no more than the amount that would be paid under reimbursement rules set forth in Chapter 42 CFR part 447.

Section 1923 of the Act requires states to make additional payments, known as DSH payments, to hospitals that serve disproportionate numbers of low-income patients with special needs. Section 1923 of the Act, however, also requires that states limit the amount of DSH payments that facilities receive. Specifically, the facility DSH limit is the cost of medical services provided to Medicaid patients, less the amount paid by the state 1) under the non-DSH payment provisions of the state Medicaid plan and 2) as supplement payments. This amount is added to the cost of medical services provided to uninsured patients, less any cash payments made by the uninsured patients, to determine the final DSH limit. The supplemental payments are additional Medicaid payments that do not violate UPL regulations, made by the State to facilities that provide services to Medicaid eligible individuals.

The State agency calculations resulted in the following inpatient UPL:

Massachusetts FY 2003 Variance Between UPL and Aggregate Medicaid Payments

Provider Type	What Medicare Would Pay (UPL)	Calculated Medicaid Payments	Budgeted Supplemental Payments	Variance
Private	\$813,354,915	\$422,008,662	\$157,700,000	\$233,346,253
Non-State-Owned Public	\$53,542,771	\$10,507,768	\$13,300,000	\$29,735,003
State-Owned Public	\$136,256,397	\$133,992,463	n/a	\$2,263,934

¹ This state plan amendment supersedes state plan amendments 01-012, 02-004 and 02-008.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

Our audit objectives were to determine whether the State agency's methodology to calculate the inpatient UPL for SFY 2003 was in accordance with the revised regulations issued by CMS and to determine if supplemental payments were included by the State agency when calculating DSH specific payment limits for SFY 2003.

Scope

We reviewed the State agency's methodology for the inpatient UPL calculation for SFY 2003, as provided to us on September 23, 2003. We did not review the management controls at the State agency because the objectives of this audit did not require an understanding or assessment of these controls. Further, we limited the scope of our review, as the inpatient UPL calculation had not been formally submitted to CMS for review. Accordingly, we did not quantify the effect that the identified weaknesses may have on the inpatient UPL calculation.

Methodology

We examined the State agency's methodology of the inpatient UPL calculation for SFY 2003 for reasonableness and accuracy. This examination included:

- verifying the calculations' mathematical accuracy,
- reviewing the calculations' methodology, and
- validating the calculations' data.

We also reviewed the State agency's DSH specific payment limit calculations for SFY 2003 to ensure supplemental payments were included.

Our fieldwork was performed from at the State agency office in Boston, Massachusetts. Our review was made in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

The State agency's methodology to calculate the inpatient UPL for SFY 2003 was not in complete accordance with the revised regulations issued by CMS. In this regard, the State agency did not include all hospital inpatient providers in the calculation or use the most accurate Medicaid claims payment data available as a basis for its UPL calculation. We found that these conditions were generally caused by a lack of certain data and clerical error. As a result, there is a risk that the State agency's inpatient UPL may be misstated and the State agency cannot provide reasonable assurances that the SFY 2003 inpatient UPL was not exceeded.

As required, the State agency included supplemental payments when calculating DSH specific payment limits for SFY 2003.

PROGRAM REQUIREMENTS

Chapter 42 CFR part 447 requires that the aggregate Medicaid payments made to private, state-owned and non-state owned public hospitals not exceed the UPL. The UPL refers to a reasonable estimate of the amount that would have been paid for the services furnished by the group of facilities under Medicare payment principles.

UPL CALCULATION

The following conditions would effect the UPL calculation if not corrected.

Inclusion of All Hospitals in UPL Calculation

Our analysis showed that all hospitals were not included in the inpatient UPL calculation. The State agency's inpatient UPL calculation was based on CMS cost report data contained in the CMS Healthcare Cost Report Information System (HCRIS). We compared the 108 in-state providers included in the UPL calculation to supplemental data and found 5 in-state providers (4 private and 1 public state-owned) were not included in the State agency's inpatient UPL calculation. We also found two out-of-state private providers, which received Medicaid payments from the State agency, were also not included in their inpatient UPL calculation.

As a result of excluding providers from the calculation, the UPL may be misstated. This misstatement would probably, but not always, result in a lower or more conservative UPL.

According to the State agency, two in-state providers were not included in the calculation because HCRIS did not contain data for either hospital. The remaining three providers were left out of the calculation due to incomplete data and clerical oversight. The two out-of-state providers were not included because data for them could not be processed in a timely manner for the calculation. The State agency plans to include these out-of-state providers in an updated UPL calculation.

Use of the Most Accurate Medicaid Payment Data

The State agency did not use the most accurate Medicaid payment data available as a basis for estimating the variance between the UPL calculation and aggregate Medicaid payments. The estimate for the SFY 2003 aggregate Medicaid payments was based on hospital FY 2002 cost reports and surveys. The State agency then applied an inflation rate of 2.226 percent to calculate all providers' FY 2003 Medicaid payments for use in the aggregated inpatient UPL calculation. We believe the State agency's use, however, of its own paid claim data for FY 2002 would have provided a more accurate calculation.

As a result of not using actual Medicaid payment data, the UPL may be misstated.

The State agency stated that time constraints precluded them from obtaining actual Medicaid payment data. The State agency acknowledged that the use of actual Medicaid payment data would be more accurate.

RECOMMENDATIONS

We recommend that the State agency work with CMS to ensure that that the SFY 2003 inpatient UPL calculation:

- includes all hospital inpatient providers, and
- uses the most accurate Medicaid payment data rather than estimates throughout the calculation.

Auditee Comments

The State agency agreed that regulation required that the UPL calculation include all hospital inpatient providers. The State agency updated its UPL calculation to include all in-state providers, but believes that excluding out-of-state providers presents a more conservative calculation. The State agency indicated that it is not required to use actual Medicaid paid claims data as the basis for calculating the UPL.

Office of Inspector General Response

We believe our recommendations are valid and the State agency should take action as appropriate. We noted that during our audit the State agreed to add out-of-state hospitals to its UPL calculation. We believe that a reasonable UPL would include data from all providers, regardless of their physical location. The State agency's contractor that developed their UPL calculation also made a similar recommendation to the State agency.

Further, we continue to believe that the State Agency should use the most accurate Medicaid paid claims data rather than estimates whenever available to ensure that the UPL calculation is reasonable in accordance with Medicaid regulations. The State agency's contractor that developed their UPL calculation also made a similar recommendation to the State agency.

APPENDIX



The Commonwealth of Massachusetts
Executive Office of Health and Human Services
Office of Medicaid
One Ashburton Place
Boston, MA 02108



MITT ROMNEY
Governor

KERRY HEALEY
Lieutenant Governor

September 1, 2005

TIMOTHY MURPHY
Secretary

BETH WALDMAN
Medicaid Director

Michael J. Armstrong
Regional Inspector General for Audit Services
US Department of Health and Human Services,
Office of Audit Services, Region 1
John F. Kennedy Federal Building
Boston, MA 02203

RE: Massachusetts Response to Draft Report #A-01-03-0009

Dear Mr. Armstrong:

The Commonwealth is submitting this letter as a response to the OIG's draft report of its review of Massachusetts' 2003 Inpatient Hospital Upper Payment Limit (UPL) calculation. We believe that a number of the recommendations made in the report are inaccurate.

While we agree that the regulation does require that all hospitals be included in the calculation of the UPL, it is the State's position that the decision to omit out-of-state hospitals is in line with our attempt to present a conservative UPL estimate. Because Massachusetts cost reports are not available for out-of-state hospitals, the State opted to exclude these hospitals so as not to bring additional variability into the calculation. Insofar as there were in-state hospitals excluded from the calculation (due to the reasons noted in the report), the calculation has been updated to include those Massachusetts providers.

These comments have been redacted as they no longer pertain to the OIG's audit report.

[Redacted content]

The Commonwealth also maintains that the law does not support the OIG's third finding requiring the use of actual Medicaid paid claims data as the basis for calculating the UPL. Where Medicaid charges and payments were derived from the State's 403 cost report, and where all payments and charges on these state cost reports are reconciled to the hospitals' audited financial statements, we believe the data used by the state in calculating its 2003 hospital UPL represent a fair and accurate measure of Medicaid reimbursement. 42 CFR 447 does not require the state to use a particular data source in estimating Medicaid payments for UPL purposes.

The state continues to believe that the payment-on-account factors (PAFs) used in the calculation are accurate. The OIG provided no specific details explaining the basis for their conclusions that there were discrepancies, and therefore, we do not agree with these findings.

In sum, we continue to believe that the UPL calculation reviewed by the OIG (including the aforementioned updates to include all Massachusetts' hospitals) complies with the 42 CFR 447, successfully presents a *conservative* estimate of the reasonable amount that would be paid under Medicare payment principles, and demonstrates that Medicaid hospital payments complied with federal upper payment limit requirements.

I would be happy to discuss these issues further with you, should you require additional information.

Sincerely,

A handwritten signature in cursive script that reads "Beth Waldman".

Beth Waldman
Medicaid Director