



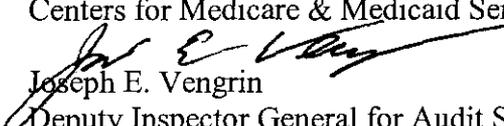
DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAR 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: Audit of New Jersey's Upper Payment Limits for State Fiscal Years 2001 Through 2003 (A-02-03-01019)

Attached is an advance copy of our final report on New Jersey's upper payment limits (UPLs). We will issue this report to the New Jersey Medicaid agency within 5 business days. Our audit was part of a multistate review of UPL calculations.

The UPL is an estimate of the amount that would be paid for Medicaid services under Medicare payment principles. Several years ago, the Centers for Medicare & Medicaid Services (CMS) revised Medicaid's UPL regulations to require that States calculate a separate UPL for each of the following categories of providers: private facilities, State facilities, and non-State government facilities. The regulations also allowed Medicaid payments up to 150 percent of the UPL for non-State government hospitals for the period March 13, 2001, to May 14, 2002. CMS subsequently retracted this provision and allowed only 100 percent of the UPL, effective May 15, 2002. Federal funds are not available for Medicaid payments that exceed these limits. New Jersey adopted the category-specific payment limits of the revised regulations in its CMS-approved State plan amendments.

Our objective was to determine, for State fiscal years (SFYs) 2001 through 2003, whether New Jersey calculated the UPLs for non-State government hospitals in accordance with Federal regulations and the approved State plan amendments.

New Jersey calculated the SFYs 2001 and 2002 UPLs for non-State government hospitals' inpatient services in accordance with Federal regulations and the approved State plan amendment. However, New Jersey did not calculate the SFY 2003 UPL in accordance with Federal regulations and the approved State plan amendment, which resulted in unallowable Medicaid payments of \$17,579,568 (\$8,789,784 Federal share). This occurred because New Jersey continued to make payments for non-State government hospitals' inpatient services up to 150 percent of the UPL after the May 15, 2002, retraction date.

New Jersey generally calculated the SFYs 2001, 2002, and 2003 UPLs for non-State government hospitals' outpatient services in accordance with Federal regulations and the

approved State plan amendment. However, New Jersey inadvertently applied an improper inflation factor in its SFY 2003 UPL calculation, which resulted in unallowable Medicaid payments of \$3,817,050 (\$1,908,525 Federal share).

We recommend that New Jersey refund to the Federal Government unallowable Medicaid payments of \$10,698,309.

In their response to our draft report, New Jersey officials concurred with the findings and recommendation.

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 Timothy J. Horgan, Regional Inspector General for Audit Services, Region II, at (212) 264-4620. Please refer to report number A-02-03-01019 in all correspondence.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES OFFICE OF INSPECTOR GENERAL

Office of Audit Services

Region II

Jacob K. Javits Federal Building

New York, New York 10278

(212) 264-4620

MAR 31 2005

Report Number: A-02-03-01019

Mr. James M. Davy
Commissioner
State of New Jersey
Department of Human Services
P.O. Box 700
Trenton, New Jersey 08625

Dear Mr. Davy:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Audit of New Jersey's Upper Payment Limits for State Fiscal Years 2001 Through 2003." A copy of this report will be forwarded to the HHS 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 action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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

Please refer to report number A-02-03-01019 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Timothy J. Horgan", written over a horizontal line.

Timothy J. Horgan
Regional Inspector General
for Audit Services

Enclosures

Page 2 – Mr. James M. Davy

Direct Reply to HHS Action Official:

Ms. Sue Kelly
Associate Regional Administrator
Division of Medicaid and Children's Health
Centers for Medicare & Medicaid Services, Region II
Department of Health and Human Services
26 Federal Plaza, Room 3811
New York, New York 10278

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF NEW JERSEY'S
UPPER PAYMENT LIMITS FOR
STATE FISCAL YEARS 2001
THROUGH 2003**



**MARCH 2005
A-02-03-01019**

Office of Inspector General

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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

The upper payment limit (UPL) is an estimate of the amount that would be paid for Medicaid services under Medicare payment principles. Several years ago, the Centers for Medicare & Medicaid Services (CMS) revised Medicaid's UPL regulations for hospitals and certain other types of providers.

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 of the following categories of providers: private facilities, State facilities, and non-State government facilities. The regulations also allowed Medicaid payments up to 150 percent of the UPL for non-State government hospitals for the period March 13, 2001, to May 14, 2002. CMS subsequently retracted this provision and allowed only 100 percent of the UPL, effective May 15, 2002. Federal funds are not available for Medicaid payments that exceed these limits. New Jersey adopted the category-specific payment limits of the revised regulations in its CMS-approved State plan amendments (SPAs).

OBJECTIVE

Our objective was to determine, for State fiscal years (SFYs) 2001 through 2003, whether New Jersey calculated the UPLs for non-State government hospitals in accordance with Federal regulations and the approved SPAs.

SUMMARY OF FINDINGS

New Jersey calculated the SFYs 2001 and 2002 UPLs for non-State government hospitals' inpatient services in accordance with Federal regulations and the approved SPA. However, New Jersey did not calculate the SFY 2003 UPL in accordance with Federal regulations and the approved SPA, which resulted in unallowable Medicaid payments of \$17,579,568 (\$8,789,784 Federal share). This occurred because New Jersey continued to make payments for non-State government hospitals' inpatient services up to 150 percent of the UPL after the May 15, 2002, retraction date.

New Jersey generally calculated the SFYs 2001, 2002, and 2003 UPLs for non-State government hospitals' outpatient services in accordance with Federal regulations and the approved SPA. However, New Jersey inadvertently applied an improper inflation factor in its SFY 2003 UPL calculation, which resulted in unallowable Medicaid payments of \$3,817,050 (\$1,908,525 Federal share).

RECOMMENDATION

We recommend that New Jersey refund to the Federal Government unallowable Medicaid payments of \$10,698,309.

STATE COMMENTS

New Jersey officials agreed with our findings and recommendation. The full text of New Jersey's comments is included as an appendix to this report.

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INTRODUCTION

BACKGROUND

Our audit was part of a multistate review of UPL calculations.

Medicaid Program

Title XIX of the Social Security Act (the Act) authorizes Federal grants to States for Medicaid programs that provide medical assistance to needy persons. Each State Medicaid program is jointly financed by the Federal and State Governments and administered by the State in accordance with a State plan approved by 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.

In New Jersey, the Department of Human Services, Division of Medical Assistance and Health Services is responsible for administering the Medicaid program. 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 as long as the payments, in total, do not exceed the UPL. The UPL is an estimate of the 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). The revised regulations required States to calculate a separate UPL for each category of provider.¹ The regulations also allowed Medicaid payments up to 150 percent of the UPL for non-State government hospitals' inpatient services for the period March 13, 2001, to May 14, 2002. CMS subsequently retracted this provision and allowed only 100 percent of the UPL, effective May 15, 2002.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine, for SFYs 2001 through 2003, whether New Jersey calculated the UPLs for non-State government hospitals in accordance with Federal regulations and the approved SPAs.

¹The three categories are privately owned and operated, State government owned or operated, and non-State government owned or operated facilities.

Scope

Our audit covered the SFYs 2001, 2002, and 2003 UPL calculations for all eight non-State government hospitals in New Jersey. We did not review the overall internal control structure of the State Department of Human Services, Division of Medical Assistance and Health Services because the objective of this audit did not require an understanding or assessment of the internal controls. However, we did gain an understanding of the State's methodology for developing the inpatient and outpatient acute care hospital computations and tested the validity of the amounts included in the calculation.

We performed fieldwork at the State Department of Human Services, Division of Medical Assistance and Health Services.

Methodology

To accomplish our objective, we:

- reviewed Federal laws and regulations pertaining to UPLs;
- held discussions with CMS Region II officials and obtained documentation related to New Jersey's UPL and State plan;
- interviewed key State agency officials involved in the UPL calculations;
- reviewed the State records supporting the UPL calculations for SFYs 2001, 2002, and 2003;
- determined whether the calculation of the UPL met the requirements established by the State agency in SPA 01-14 and SPA 01-16 and the requirements imposed by 42 CFR § 447;
- traced supporting expenditures that the State agency used to calculate the UPLs to hospital cost reports, which are the basis for claims in the State Medicaid Management Information System, and verified that the State used that system to determine the hospital costs included in the CMS-64 claim; and
- discussed our audit results with State officials.

We performed our review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATION

New Jersey calculated the SFYs 2001 and 2002 UPLs for non-State government hospitals' inpatient services in accordance with Federal regulations and the approved SPA. However, New Jersey did not calculate the SFY 2003 UPL in accordance with Federal regulations and the

approved SPA, which resulted in unallowable Medicaid payments of \$17,579,568 (\$8,789,784 Federal share). This occurred because New Jersey continued to make payments for non-State government hospitals' inpatient services up to 150 percent of the UPL after the May 15, 2002, retraction date.

New Jersey generally calculated the SFYs 2001, 2002, and 2003 UPLs for non-State government hospitals' outpatient services in accordance with Federal regulations and the approved SPA. However, New Jersey inadvertently applied an improper inflation factor in its SFY 2003 UPL calculation, which resulted in unallowable Medicaid payments of \$3,817,050 (\$1,908,525 Federal share).

NON-STATE GOVERNMENT HOSPITALS' INPATIENT SERVICES

Effective March 13, 2001, CMS revised Medicaid's UPL regulations for non-State government hospitals. The UPL is an estimate of the amount that would be paid for Medicaid services under Medicare payment principles. The regulations allowed Medicaid payments up to 150 percent of the UPL for non-State government hospitals' inpatient services. CMS subsequently retracted this provision and allowed only 100 percent of the UPL, effective May 15, 2002. New Jersey adopted these UPL requirements in its SPA.

We reviewed the inpatient calculation of the SFYs 2001, 2002, and 2003 UPLs for eight non-State government hospitals. We found that the State calculated the SFYs 2001 and 2002 UPLs in accordance with revised Federal regulations and the approved SPA. However, for SFY 2003, the State incorrectly continued to use the 150-percent Maximum Adjustment Factor in its UPL calculation after the May 15, 2002, retraction date. This error resulted in overpayments of \$17,579,568 (\$8,789,784 Federal share) for non-State government hospitals' inpatient services.

We discussed this finding with New Jersey officials, who concurred and advised us that they continued to calculate the UPL for non-State government hospitals at 150 percent of the computed UPL because the formula was inadvertently left in the SFY 2003 calculation.

Table 1 shows the excess amount paid to the eight hospitals and claimed to the Federal Government as a result of the application of 150 percent of the computed UPL for SFY 2003.

Table 1: Payments for Inpatient Services in Excess of Allowable UPL

	<u>Total</u>	<u>Federal Share</u>
Medicaid Payments at 150% UPL	\$95,698,197	\$47,849,099
Less allowable UPL at 100%	78,118,629	39,059,315
Payments in Excess of Allowable UPL	\$17,579,568	\$8,789,784

NON-STATE GOVERNMENT HOSPITALS' OUTPATIENT SERVICES

New Jersey generally calculated the SFYs 2001, 2002, and 2003 UPLs for three² non-State government hospitals in accordance with revised Federal regulations and the approved SPA. However, New Jersey inadvertently applied an improper inflation factor in its SFY 2003 UPL calculation.

As part of its SFYs 2001, 2002, and 2003 UPL calculations for non-State government hospitals' outpatient services, the State elected to apply annual Tax Equity and Fiscal Responsibility Act (TEFRA) and Technology inflation factors to its calculated Medicaid UPL base-year costs as a method of increasing the applicable costs to current-year levels. The TEFRA inflation factors are published in the Federal Register, and the Technology factors are included in the Medicare Payment Policy Report to Congress.

New Jersey's outpatient UPL calculation consisted of multiplying the TEFRA and Technology inflation factors for each year and then applying the products to the base year. New Jersey made a calculation error in the application of these two factors. For SFY 2003, New Jersey applied an inflation factor of 1.330 percent instead of the correct rate of 1.199 percent, which resulted in excess Medicaid payments of \$3,817,050 (\$1,908,525 Federal share).

We discussed this finding with New Jersey officials, who concurred that an error was made in the calculation of the SFY 2003 outpatient UPL.

Table 2 shows the excess amount paid to the three hospitals and claimed to the Federal Government as a result of the application of an incorrect inflation factor.

Table 2: Payments for Outpatient Services in Excess of Allowable UPL

	<u>Total</u>	<u>Federal Share</u>
SFY 2003 Medicaid Payments	\$46,567,596	\$23,283,798
Less allowable SFY 2003 UPL	42,750,546	21,375,273
Payments in Excess of Allowable UPL	\$3,817,050	\$1,908,525

RECOMMENDATION

We recommend that New Jersey refund to the Federal Government unallowable Medicaid payments of \$10,698,309.

STATE COMMENTS

The full text of New Jersey's comments is included as an appendix to this report. In summary, New Jersey officials agreed with the findings and recommendation, including the \$10,698,309

²The State included only three of the eight non-State government hospitals' outpatient service costs in the UPL calculations.

refund. The officials stated that they would process a decreasing adjustment for this amount with the next quarterly submission of the CMS-64.

APPENDIX



State of New Jersey
DEPARTMENT OF HUMAN SERVICES
DIVISION OF MEDICAL ASSISTANCE AND HEALTH SERVICES
PO Box 712

TRENTON, NJ 08625-0712
TELEPHONE 1-800-354-1561

RICHARD J. CODEY
Acting Governor

JAMES M. DAVY
Commissioner

ANN CLEMENCY KOFFER
Director

March 3, 2005

Timothy J. Horgan
Regional Inspector General
for Audit Services
Office of the Inspector General
Office of Audit Services
Jacob K. Javits Federal Building
28 Federal Plaza
New York, New York 10278

Re: Report Number A-02-03-01019

Dear Mr. Horgan:

I am writing in response to your correspondence of January 31, 2005 concerning the draft audit report entitled "Audit of New Jersey's Upper Payment Limits for State Fiscal Years 2001 through 2003." Your letter provides an opportunity to comment on the draft audit report.

The draft report contains two findings and one recommendation. The report makes the following findings: 1) As a result of improperly calculating the UPL for non-State government hospitals at 150 percent of the computed Upper Payment Limit (UPL) instead of the allowable 100 percent, New Jersey improperly reimbursed non-State government hospitals for inpatient services for SFY 2003 for a total of \$17,579,568 (\$8,789,784 Federal share) in excess of allowable UPL and 2) as a result of applying an incorrect inflation factor, New Jersey improperly reimbursed non-State government hospitals for outpatient services for SFY 2003 for a total of \$3,817,050 (\$1,908,525 Federal share) in excess of allowable UPL.

A review of the available documentation indicates that the findings in the audit report are correct. The Division of Medical Assistance and Health Services (DMAHS) has revised the UPL calculation for SFY 2004 to ensure that the 150 percent of allowable costs is excluded from the calculation.

Timothy J. Horgan
March 3, 2005
Page 2

As to the finding that DMAHS incorrectly applied an inflation factor of 1.330 percent, DMAHS has revised its calculations for SFY 2004 to ensure that the correct inflation factor is used.

In summary, the recommendation contained in the report and our response is provided below:

The Division of Medical Assistance and Health Services should refund \$10,698,309 to the federal government for unallowable Medicaid payments for hospital services in excess of the allowable SFY 2003 UPL.

As explained above, New Jersey does agree with the recommendation that the payment amount in excess of the UPL was unallowable and should be refunded. A decreasing adjustment for this amount will be processed with the next quarterly submission of the CMS-64.

The opportunity to review and comment on this draft audit report is greatly appreciated. If you have any questions or require additional information, please contact me or Michael Keevey at (609) 588-2668.

Sincerely,



Ann Clemency Kohler
Director

ACK:N

c: James M. Davy
Michael Keevey
David Lowenthal

ACKNOWLEDGMENTS

This report was prepared under the direction of Timothy J. Horgan, Regional Inspector General for Audit Services. Other principal Office of Audit Services staff who contributed include:

John J. Madigan, Audit Manager
Anthony Manno, Senior Auditor
Stephanie Iseman, Auditor
Mark Blatt, Auditor
Peili Yao, Auditor

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