Report Number: A-04-03-02026

Ms. Carie Summers, Chief Financial Officer
State of Georgia Community Health
Division of Medical Assistance
2 Peachtree Street, N.W.
Atlanta, Georgia 30303-3159

Dear Ms. Summers:

Enclosed are two copies of the Office of Inspector General (OIG) final report entitled “Audit of Georgia’s Medicaid Upper Payment Limit Payments for Non-State Government Inpatient Hospitals.” 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 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, 5 U.S.C. 552, as amended by Public Law 104-231, OIG reports are made available to members of the press and the general public to the extent the information is not subject to exemptions in the Act which the department chooses to exercise (see 45 CFR Part 5).

If you have any questions or comments about this report, please contact me at 404-562-7750 or have your staff contact Peter Barbera, Audit Manager at 404-562-7758. To facilitate identification, please refer to report number A-04-03-02026 in all correspondence relating to this report.

Sincerely,

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

Enclosures – as stated
Direct Reply to HHS Action Officials:

Mr. Renard L. Murray  
Associate Regional Administrator  
Centers for Medicare & Medicaid Services  
Division of Medicaid & Children’s Health  
U.S. Department of Health and Human Services  
61 Forsyth Street, S.W., Suite 4T20  
Atlanta, Georgia 30303-8909
AUDIT OF GEORGIA’S MEDICAID UPPER PAYMENT LIMIT PAYMENTS FOR NON-STATE GOVERNMENT INPATIENT HOSPITALS

Daniel R. Levinson
Inspector General

AUGUST 2005
A-04-03-02026
The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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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 the information is not subject to exemptions in the act. (See 45 CFR Part 5.)

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 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 inpatient 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 created transition periods in which eligible States were allowed to make payments up to the category-specific UPL plus an excess amount (the portion of Medicaid payments that exceeded the UPL in the applicable base year). States do not qualify for a transition period if payments to non-State government facilities did not exceed 150 percent of the category-specific UPL in the base year. Federal funds are not available for Medicaid payments that exceed the UPL plus the excess amount.

Georgia adopted the category-specific payment limits of the revised regulations in its CMS-approved State plan amendments.

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 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 Georgia, from July 2002 through December 2002:

- calculated the UPL for non-State government inpatient hospitals in accordance with Federal regulations and the approved State plan amendments; and
- properly included UPL payments in the calculation of hospital-specific DSH limits.
SUMMARY OF FINDINGS

After issuing the draft report, the State informed us that it received CMS approval to retroactively change the methodology used to determine UPL calculations (see Appendix C). Because of CMS’s actions, the methodology we reviewed is no longer applicable and our UPL findings have been negated. However, the prior methodology used to calculate Georgia’s non-State government inpatient UPL did not comply with Federal regulations or the approved State plan amendments. As a result, Georgia made UPL overpayments of $67.5 million ($40.2 million Federal share). On a separate matter, Georgia may have overstated its DSH limits by not including $144 million in UPL payments in the State fiscal year (SFY) calculation.

UPL Calculation

Georgia’s inpatient hospital UPL calculation for the first 6 months of SFY 2003 (July through December 2002) did not comply with Federal regulations or the approved State plan amendments. As a result, the State made UPL overpayments of almost $67.5 million ($40.2 million Federal share). About $54.9 million of the $67.5 million represented excess amount payments that were unallowable because the State’s base-year payments did not exceed the 150 percent threshold necessary to qualify for a transition period and make such payments. The remaining $12.6 million resulted from the State’s improper calculation of the category-specific UPL.

Calculation of Hospital-Specific DSH Limits

Contrary to Federal law, Georgia did not include $144 million in UPL payments in its calculation of hospital-specific DSH limits for SFY 2003. As a result, the hospital-specific DSH limits were likely overstated. However, in December 2001, CMS granted the State a waiver allowing the inclusion of the UPL payments in future years’ DSH limit calculations. Consequently, we have no recommendations on this matter.

RECOMMENDATIONS

Based on CMS’s actions, we have no recommendations.

Auditee Comments

The State replied that after our review it received CMS approval to retroactively change the methodology used in its UPL calculations during the audit period. Since a new methodology is now applicable for the time period covered in the audit (as well as future periods), the State does not believe the recommendations apply and no refund is necessary. The State’s complete response is included as Appendix C to the report.
Office of Inspector General Response

After issuing our draft report, we were informed that the State received CMS approval to retroactively change the methodology used to determine UPL calculations. The new methodology is applicable during the audit period and for future periods because it relies on actual Medicare payments and charges instead of converting Medicaid DRGs to Medicare DRGs for hospital-specific UPL calculations. The financial impact of the change in methodology is not known at this time because it has not been reviewed. Additionally, the transitional allowance (excess amount payments) is not applicable to this new methodology. Because of CMS’s actions, the methodology we reviewed is no longer applicable and our UPL findings have been negated.
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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.

In Georgia, the Department of Community Health 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 inpatient hospitals as long as the payments, in total, do not exceed the UPL.\(^1\) 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.\(^2\) 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 (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. Georgia adopted the category-specific payment limits of the revised regulations in its CMS-approved State plan amendments.

Disproportionate Share Hospital Payments

Section 1923 of the Act requires States to make disproportionate share hospital (DSH) payments to hospitals serving 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. Uncompensated care costs are the costs of medical services provided to Medicaid and uninsured patients, less payments

---

1\(^{For}\) non-State government hospitals, Federal regulations allowed Medicaid payments up to 150 percent of the UPL from March 13, 2001, to May 14, 2002.

2\(^{The}\) three categories are privately owned and operated, State government owned or operated, and non-State government owned or operated facilities.
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.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine whether Georgia, from July through December 2002:

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

Scope

Our audit covered the State’s UPL calculations for payments to non-State government inpatient hospitals during the first 6 months of State fiscal year (SFY) 2003 (July 1 through December 31, 2002). We also reviewed Georgia’s State plan amendments 93-047, 99-019, and 01-003 and the related UPL and DSH payments made during the first 6 months of SFY 2003. During this period, the State made UPL payments of about $144 million and DSH payments of about $366 million.

Our review of internal controls was limited to procedures followed by the State in its UPL and DSH calculations. We did not review the overall internal control structure of the State Department of Community Health because we accomplished the objectives of our audit through substantive testing.

We performed fieldwork at the State Department of Community Health in Atlanta, GA.

We obtained the State’s written comments to our report. The State’s comments have been incorporated into the body of the report and included in their entirety as Appendix C.

Methodology

To accomplish our objectives, we:

- reviewed Federal laws and regulations pertaining to UPLs and DSH payments,
- compared Federal regulatory requirements with the methodology for calculating UPLs established in State plan amendments 93-047 and 01-003 for non-State government inpatient hospitals,
- reviewed classifications of inpatient hospitals to verify that UPL calculations included only non-State government inpatient hospitals,
• tested the accuracy of underlying Medicaid and Medicare data that Georgia used to calculate UPLs,

• traced the UPL payments to the CMS-64 quarterly expenditure report to determine whether the State claimed the payments for Federal reimbursement,

• reviewed the State’s conversion of Medicaid diagnosis-related groups (DRG) to Medicare DRGs by selecting a statistical random sample of Medicaid paid claims from the 93 hospitals that received UPL payments,

• reviewed documentation from the base year (SFY 2000) because the State claimed excess amount payments during our audit period based on SFY 2000 data, and

• reviewed supporting records to determine whether the State included UPL payments in the calculation of hospital-specific DSH limits.

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

FINDINGS AND RECOMMENDATIONS

After issuing the draft report, the State informed us that it received CMS approval to retroactively change the methodology used to determine UPL calculations (see Appendix C). Because of CMS’s actions, the methodology we reviewed is no longer applicable and our UPL findings have been negated. However, the prior methodology used to calculate Georgia’s non-State government inpatient UPL calculation for the first 6 months of SFY 2003 (July through December 2002) did not comply with Federal regulations or the approved State plan amendments. As a result, Georgia made UPL overpayments of $67.5 million ($40.2 million Federal share). About $54.9 million of the $67.5 million represented excess amount payments that were unallowable because the State’s base-year payments did not exceed the 150 percent threshold necessary to qualify for a transition period and make such payments. The remaining $12.6 million resulted from the State’s improper calculation of the category-specific UPL.

On a separate matter, Georgia did not include $144 million in UPL payments in its calculation of hospital-specific DSH limits for SFY 2003, contrary to Federal law. As a result, the hospital-specific DSH limits were likely overstated. However, in December 2001, CMS granted the State a waiver allowing the inclusion of the UPL payments in future years’ DSH limit calculations. Consequently, we have no recommendations on this matter.

UPPER PAYMENT LIMIT CALCULATION

Georgia’s noncompliance with Federal regulations and its approved State plan amendments for the first 6 months of SFY 2003 resulted in almost $67.5 million in unallowable payments, as shown below.
### Unallowable Upper Payment Limit Payments

<table>
<thead>
<tr>
<th>Ineligible Excess Amount Payments</th>
<th>Total</th>
<th>Federal Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improper UPL Calculation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improper Conversion of Medicaid DRGs to Medicare DRGs</td>
<td>12,008,411</td>
<td>7,157,013</td>
</tr>
<tr>
<td>Unsupported Lag Factor Adjustment</td>
<td>604,723</td>
<td>360,415</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$67,466,742</strong></td>
<td><strong>$40,210,178</strong></td>
</tr>
</tbody>
</table>

#### Ineligible Excess Amount Payments

During the audit period, Georgia claimed about $54.9 million in payments related to the excess amount but had not met the Federal requirements to qualify for making those payments.

Federal regulations (42 CFR § 447.272), effective March 13, 2001, allowed States to make excess amount payments during a transition period if the States met certain requirements. Pursuant to 42 CFR § 447.272(e)(2)(v), a State with an approved State plan amendment does not qualify for a transition period if the State’s base-year payments to non-State government facilities did not exceed 150 percent of the UPL.

Georgia was not eligible to make excess amount payments because it could not demonstrate that it exceeded the 150 percent threshold in the base year (SFY 2000). The available documentation showed that Georgia’s base-year payments did not exceed 150 percent of the base-year category-specific UPL. That UPL was about $532 million. Therefore, the 150 percent threshold was about $798 million. In total, Georgia made Medicaid claim payments and UPL payments totaling about $701 million, or about $97 million less than needed to qualify for transition payments.

Because Georgia had not met the 150 percent payment threshold in its base year, it reclassified $97 million of prior years’ DSH payments as base-year payments. Through this reclassification, the State represented that DSH payments made from SFY 1995 through SFY 1999 were to be recognized as UPL payments in the base year and that total UPL payments made in the base year exceeded 150 percent of the base-year category-specific UPL.

Federal regulations (42 CFR § 447.272(e)) specify that States may use only SFY 2000 payments in computing the excess amount. In this regard, CMS officials from the National Institutional Reimbursement Team concurred with our opinion that the reclassification of prior-year DSH payments as base-year UPL payments was not acceptable. The officials also agreed with our assessment that Georgia was not eligible to make excess amount payments because Georgia’s aggregate inpatient hospital payments in SFY 2000 did not exceed 150 percent of the UPL.

Since the State did not exceed the 150 percent threshold, it was not eligible to make excess amount payments. Consequently, Georgia made excessive UPL payments of $54,853,608 ($32,692,750 Federal share).
Improper Upper Payment Limit Calculation

In calculating its SFY 2003 category-specific UPL, Georgia used methodologies that improperly inflated the UPL by about $12.6 million ($7.5 million Federal share). The methodologies included:

- an improper conversion of Medicaid DRGs to Medicare DRGs and
- an unsupported lag factor adjustment.

Improper Conversion of Medicaid Diagnosis-Related Groups to Medicare Diagnosis-Related Groups

Georgia’s SFY 2003 category-specific UPL calculation included converting the value of its Medicaid DRG payment rates to what Medicare would have paid (Medicare DRGs). However, Georgia’s methodology for determining a conversion rate was inconsistent with Medicare payment principles.

Regulations (42 CFR § 447.272) define the UPL as a reasonable estimate of the amount that would be paid to the State for Medicaid services under Medicare payment principles. Medicare payment principles require a match between the dates of service for claims and the pricing of the claims. Payments should be based on the date of the patient’s discharge and the rates in effect on that date. For example, a claim with a discharge date in Federal fiscal year (FFY) 1999 should be priced using a FFY 1999 payment rate.

Georgia’s SFY 2003 category-specific UPL calculation was in part based on Medicaid payments in SFYs 1998 and 1999. One step in the calculation included converting the SFYs 1998 and 1999 Medicaid DRG payment rates to Medicare DRG payment rates. That conversion was not reasonable because the State did not use the proper Medicare DRG payment rates contained in Medicare’s Pricer software. The State used a FFY 2000 Pricer instead of the FFYs 1998 and 1999 Pricers. In most cases, the FFY 2000 Pricer included higher Medicare payment rates than those paid in FFYs 1998 and 1999; therefore, the use of the FFY 2000 Pricer resulted in an inflated value of what Medicare would have paid in FFYs 1998 and 1999. As a result, the calculated variance between Medicaid DRGs and Medicare DRGs was overstated, which improperly inflated the DRG conversion rate.

Based on this DRG conversion, Georgia determined that Medicare would have paid 31.2 percent more than what Medicaid paid for like services in SFYs 1998 and 1999. Accordingly, Georgia increased its SFY 2003 Medicaid DRG payments by 31.2 percent to compute the UPL.

Using the proper Medicare Pricers for a statistical sample of Medicaid claims included in the State’s DRG conversion, we calculated a DRG conversion rate of 26.05 percent (see Appendixes A and B). The State’s use of the FFY 2000 Medicare Pricer to value its SFY 1998 and 1999 Medicaid payment rates unreasonably inflated the conversion rate by about 5 percent (31.2 percent minus 26.05 percent). Thus, the UPL calculation was overstated to this extent, and
the State made excessive category-specific UPL payments totaling $12,008,411 ($7,157,013 Federal share).

**Unsupported Lag Factor Adjustment**

Georgia proposed a lag factor of 17.443 percent to account for a timing difference between the dates that services were performed and payments were made. However, Georgia could not adequately support the entire rate increase.

States are required to maintain adequate documentation of payment rates (42 CFR § 447.203). Based on available documentation, we found that the rate should have been 16.47 percent, rather than 17.443 percent. Consequently, the UPL was overstated, and the State made excessive payments totaling $604,723 ($360,415 Federal share).

**CALCULATION OF HOSPITAL-SPECIFIC DISPROPORTIONATE SHARE HOSPITAL LIMITS**

Contrary to Federal law, Georgia did not include excess amount and category-specific UPL payments in its calculation of the SFY 2003 hospital-specific DSH limits. From July 1 through December 31, 2002, Georgia made approximately $366 million in DSH payments. Georgia also made about $144 million in excess amount and category-specific UPL payments, which should have been treated as a reduction in the calculation of the DSH limits.

Section 1923 of the Act limits a hospital’s Medicaid DSH payments to the costs of medical services provided to Medicaid and uninsured patients less payments (such as excess amount and category-specific UPL payments) received for those patients.

Based on payment data through December 2002, no DSH overpayment has occurred. However, if the State made DSH payments up to the improperly calculated DSH limit, overpayments may have occurred in SFY 2003.

The State and CMS have reached an agreement allowing the State to defer consideration of the $144 million in excess amount and category-specific UPL payments to future DSH limit calculations. In a December 20, 2001, letter to Georgia, CMS stated “. . . [as] UPL payments made under this plan will be incorporated in future uncompensated care calculations, we are pleased to inform you that this amendment to your Title XIX State Plan is approved.” Consequently, we have no recommendations on this matter.
RECOMMENDATIONS

Based on CMS’s actions, we have no recommendations.

Auditee Comments

The State replied that after our review it received CMS approval to retroactively change the methodology used in its UPL calculations during the audit period. Since a new methodology is now applicable for the time period covered in the audit (as well as future periods), the State does not believe the recommendations apply and no refund is necessary. The State’s complete response is included as Appendix C to the report.

Office of Inspector General Response

After issuing our draft report, we were informed that the State received CMS approval to retroactively change the methodology used to determine UPL calculations. The new methodology is applicable during the audit period and for future periods because it relies on actual Medicare payments and charges instead of converting Medicaid DRGS to Medicare DRGs for hospital-specific UPL calculations. The financial impact of the change in methodology is not known at this time because it has not been reviewed. Additionally, the transitional allowance (excess amount payments) is not applicable to this new methodology. Because of CMS’s actions, the methodology we reviewed is no longer applicable and our UPL findings have been negated.
APPENDIXES
APPENDIX A

SAMPLING METHODOLOGY

OBJECTIVE

Our objective was to determine if Georgia correctly converted Medicaid DRG amounts to Medicare DRG amounts and to determine if the 31.2 percent DRG conversion rate that Georgia used in its UPL calculation was reasonable.

POPULATION

The population consisted of 113,066 Medicaid paid claims from the 93 hospitals that received UPL payments.

SAMPLE UNIT

The sample unit was a Medicaid paid claim from the State’s UPL calculation. Those claims were paid from July 1, 1998, through June 30, 1999.

SAMPLE DESIGN

We used a simple random sample.

SAMPLE SIZE

We selected 200 claims from the population.

ESTIMATION METHODOLOGY

We projected the correct Medicare pricing using the Department of Health and Human Services, Office of Audit Services RAT-STATS Variables Appraisal Program. Because Georgia’s amount ($497,053,970) was greater than the upper limit, we used the upper limit of the 90 percent confidence interval to compute the amount that should have been used. We then compared this revised amount with what Medicaid paid for the claims ($375,705,023) to determine the percentage of increase for use in the State’s UPL calculation.
SAMPLE RESULTS AND PROJECTIONS

SAMPLE RESULTS

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<tr>
<th>Sample Size</th>
<th>Value of Sample</th>
<th>Number of Nonzero Errors</th>
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<tr>
<td>200</td>
<td>$734,604</td>
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</tr>
</tbody>
</table>

VARIABLE PROJECTIONS

Point Estimate $415,293,532

90 Percent Confidence Interval:
- Lower Limit $357,006,930
- Upper Limit $473,580,134

SUMMARY OF RESULTS

Using the upper limit at the 90 percent confidence interval, Medicare would have paid, at the most, $473,580,135 for claims for which Medicaid paid $375,705,023. This Medicare total is 26.05 percent higher than the Medicaid total ($473,580,135/$375,705,023 = 126.05 percent). Therefore, we believe that the State should have used 26.05 percent, rather than 31.2 percent, as the conversion rate in its UPL calculation.
March 14, 2005

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

Re: Report Number A-04-03-02026

Dear Ms. Pilcher:

We have reviewed your letter dated February 17, 2005, and accompanying draft report (the report) entitled “Audit of Georgia’s Medicaid Upper Limits for Non-State Government Inpatient Hospitals.” As requested, our comments on the draft audit report follow:

The department does not agree a Federal Government refund is necessary for $40,210,178 in Upper Payment Limit (UPL) payments made to non-state government inpatient hospitals for the 6 months of state fiscal year 2003. Subsequent to the OIG review and discussions with the Centers for Medicare and Medicaid Services (CMS), the state received CMS approval to retroactively change its methodology used to determine UPL calculations. The new methodology relies on actual Medicare payments and charges instead of converting Medicaid DRGs to Medicare DRGs for hospital-specific UPL calculations. While lag factors are a component of the new methodology, the state did not need to estimate the lag factors since the state was able to use actual lag factors based on Medicaid claims data. The transitional allowance is not applicable to this new methodology.

Because a new, CMS-approved methodology is now applicable during the time period covered in your review (as well as for future periods), we believe that your recommendations do not apply at this time. We appreciate the opportunity to respond to this draft report. If you need further information, please contact Alan Sacks, Audit Coordinator, at (404) 657-7113.

Sincerely,

[Signature]

Carie Summers
Chief Financial Officer

C: Jim Connolly
Alan Sacks
This report was prepared under the direction of Lori S. Pilcher, Regional Inspector General for Audit Services, Region IV. Other principal Office of Audit Services staff who contributed include:

Peter J. Barbera, Audit Manager
Tim Romero, Senior Auditor
Eric Bowen, Senior Auditor
Mark Mathis, Auditor

For information or copies of this report, please contact the Office of Inspector General’s Public Affairs office at (202) 619-1343.