



JUL 29 2005

**TO:** Mark B. McClellan, M.D., Ph.D.  
Administrator  
Centers for Medicare & Medicaid Services

**FROM:** Daniel R. Levinson *Daniel R. Levinson*  
Inspector General

**SUBJECT:** Review of North Carolina's Medicaid Upper-Payment-Limit Calculations for Non-State Government and Private Hospitals (A-04-03-02028)

Attached is an advance copy of our final report on North Carolina's Medicaid upper-payment-limit (UPL) calculations. We will issue this report to North Carolina within 5 business days.

The 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 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. Federal funds are not available for State expenditures that exceed these limits. Further, by statute, States must consider UPL payments and other payments received on behalf of Medicaid and uninsured patients when calculating hospital-specific disproportionate share hospital (DSH) payment limits. Medicaid makes DSH payments to hospitals that serve disproportionate numbers of low-income patients with special needs.

Our objectives were to determine whether North Carolina:

- calculated the UPLs for non-State government and private outpatient and 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.

North Carolina calculated the State fiscal year (SFY) 2003<sup>1</sup> hospital outpatient UPLs in compliance with Federal regulations and the approved State plan amendment. However, North Carolina's calculation of the SFY 2003 hospital inpatient UPLs did not comply with its State plan amendment. As a result, during our audit period (the first 9 months of SFY 2003), the State made unallowable hospital inpatient UPL payments of about \$42 million (\$26 million Federal share). The \$42 million in unallowable payments is subject to future adjustment during final cost settlement. The cost settlement process has been a State plan requirement since 1995; however, no final cost settlements have occurred since 1996.

<sup>1</sup>North Carolina's SFY 2003 began July 1, 2002, and ended June 30, 2003.

Also, contrary to Federal law and CMS policy guidance, North Carolina did not include UPL payments in its calculation of SFY 2003 hospital-specific DSH limits. The DSH limits were therefore inflated. As of the end of our audit period, no DSH overpayment had occurred. However, if the State had made DSH payments up to the improperly calculated DSH limits at any time during the remainder of the SFY, an overpayment would have occurred. The potential overpayment would have been at least \$42 million considering the impact of the excessive UPL payments cited above. Determining the actual DSH overpayment would require a final cost settlement.

The State and CMS are working to resolve outstanding issues affecting the final cost settlements for both UPL and DSH payments for all years since 1996.

We recommend that North Carolina:

- make future estimated inpatient UPL payments based on a UPL properly computed using Medicaid costs incurred instead of charges converted to costs;
- revise its calculation of hospital-specific DSH limits to include properly computed UPL payments; and
- resolve with CMS all outstanding issues affecting final cost settlements and, upon resolution, perform annual final cost settlements and refund the Federal share of any UPL and DSH overpayments.

In its comments on the draft report, the State did not specifically address our first two recommendations. With respect to the third recommendation, the State said that any action must await the conclusion of discussions with CMS to resolve several technical and legal issues. Based on the State's comments, we modified this recommendation. As our report indicates, it is not yet possible to determine final overpayment amounts because the State has not performed final cost settlements.

If you have any questions or comments about this report, please do not hesitate to call me, or one of your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or Lori S. Pilcher, Regional Inspector General for Audit Services, Region IV, at (404) 562-7750.

Attachment



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

REGION IV

61 Forsyth Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

AUG - 1 2005

Report Number: A-04-03-02028

Ms. Carmen Hooker Odom  
Secretary, North Carolina Department of Health  
and Human Services  
Adams Building, 101 Blair Drive  
Raleigh, North Carolina 27603

Dear Ms. Odom:

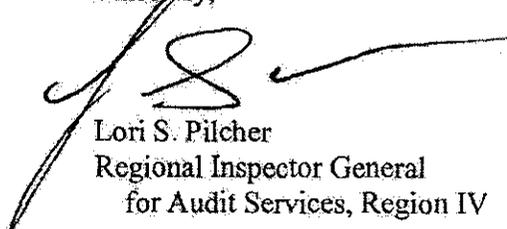
Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of North Carolina's Medicaid Upper-Payment-Limit Calculations for Non-State Government and Private Hospitals." A copy of this report will be forwarded to the action official noted below for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days 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.

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Please refer to report number A-04-03-02028 in all correspondence.

Sincerely,



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

Enclosures

Page 2 – Ms. Carmen Hooker Odom

**Direct Reply to HHS Action Official:**

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Associate Regional Administrator  
Division of Medicaid & Children's Health  
Centers for Medicare & Medicaid Services  
U.S. Department of Health and Human Services  
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Atlanta, Georgia 30303-8909

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF NORTH CAROLINA'S  
MEDICAID UPPER-PAYMENT-LIMIT  
CALCULATIONS FOR NON-STATE  
GOVERNMENT AND PRIVATE  
HOSPITALS**



**Daniel R. Levinson  
Inspector General**

**AUGUST 2005  
A-04-03-02028**

# *Office of Inspector General*

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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 hospitals and certain other types of providers.

The revised regulations changed the manner in which States calculate the UPL for various categories of providers. Pursuant to the former rule, States were required to calculate a UPL for all facilities and another UPL for State-owned facilities. The revised regulations instead require States to calculate a separate UPL for each of the following categories of providers: private facilities, State facilities, and non-State government facilities. The regulations also created transition periods in which eligible States were allowed to make payments up to the category-specific UPL plus an excess amount, which is calculated based on the portion of Medicaid payments that exceeded the UPL in the applicable base year. Federal funds are not available for State expenditures that exceed these limits. North Carolina 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 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 North Carolina:

- calculated the UPLs for non-State government and private outpatient and 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**

### **Upper-Payment-Limit Calculations**

North Carolina calculated the State fiscal year (SFY) 2003 hospital outpatient UPLs in compliance with Federal regulations and the approved State plan amendment.<sup>1</sup> However, North Carolina's calculation of the SFY 2003 hospital inpatient UPLs did not comply with its State plan amendment. As a result, during our audit period (the first 9 months of SFY 2003), the State made unallowable hospital inpatient UPL payments of about \$42 million (\$26 million Federal share).

The State plan required that estimated UPL payments be based on costs incurred for hospital inpatient services and that these costs be obtained from the most recently filed hospital cost reports. Instead of using costs incurred as reported on hospital cost reports, in July 2002, the State began using inpatient Medicaid charges converted to costs as obtained from its fiscal agent. CMS did not approve this change.

The \$42 million in unallowable payments is subject to future adjustment. To determine the final figure would require a final cost settlement as required by the State plan. The cost settlement process has been a State plan requirement since 1995; however, no final cost settlements have occurred since 1996. We have been informed that the State and CMS are working to resolve outstanding issues affecting the final cost settlements for UPL payments for all years since 1996.

### **Calculation of Hospital-Specific Disproportionate Share Hospital Limits**

Contrary to Federal law and CMS policy guidance, North Carolina did not include UPL payments in its calculation of SFY 2003 hospital-specific DSH limits. The DSH limits were therefore inflated.

As of the end of our audit period, no DSH overpayment had occurred. However, if the State had made DSH payments up to the improperly calculated DSH limits at any time during the remainder of the SFY, an overpayment would have occurred. The potential overpayment would have been at least \$42 million considering the impact of the excessive UPL payments cited above.

We were unable to determine the final DSH overpayment because doing so would require a final cost settlement as required by the State plan. The State and CMS are working to resolve outstanding issues affecting the final cost settlements for DSH payments for all years since 1996.

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<sup>1</sup>North Carolina's SFY 2003 began July 1, 2002, and ended June 30, 2003.

## **RECOMMENDATIONS**

We recommend that North Carolina:

- make future estimated inpatient UPL payments based on a UPL properly computed using Medicaid costs incurred instead of charges converted to costs;
- revise its calculation of hospital-specific DSH limits to include properly computed UPL payments; and
- resolve with CMS all outstanding issues affecting final cost settlements and, upon resolution, perform annual final cost settlements and refund the Federal share of any UPL and DSH overpayments.

## **STATE'S COMMENTS**

In its comments on the draft report, the State did not specifically address our first two recommendations. With respect to the third recommendation, the State said that any action must await the conclusion of discussions with CMS to resolve several technical and legal issues. The State's comments are included in their entirety as an appendix to this report.

## **OFFICE OF INSPECTOR GENERAL'S RESPONSE**

Based on the State's comments, we modified the third recommendation. As our report indicates, it is not yet possible to determine final overpayment amounts because the State has not performed final cost settlements.

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# INTRODUCTION

## BACKGROUND

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

### Medicaid Program

Title XIX of the Social Security Act (the Act) authorizes Federal grants to States for Medicaid programs that provide medical assistance to needy persons. Each State Medicaid program is jointly financed by the Federal and State Governments and administered by the State in accordance with a State plan approved by CMS. While the State has considerable flexibility in designing its plan and operating its Medicaid program, it must comply with Federal requirements. The Federal Government pays its share of Medicaid expenditures to a State according to a formula shown in section 1905(b) of the Act. Within the Federal Government, CMS administers the program.

### Upper Payment Limits

State Medicaid programs have flexibility in determining payment rates for Medicaid providers. CMS has allowed States to use different rates to pay hospitals as long as the payments, in total, do not exceed the UPL.<sup>1</sup> 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 for hospital inpatient payments and 42 CFR § 447.321 for hospital outpatient payments) in 2001. The revised regulations require States to calculate a separate UPL for each category of provider.<sup>2</sup> 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, which is calculated based on the portion of Medicaid payments that exceeded the UPL in the applicable base year. Federal funds are not available for State expenditures that exceed these limits.

### Disproportionate Share Hospital Payments

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

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<sup>1</sup>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.

<sup>2</sup>The three categories are privately owned and operated, State government owned or operated, and non-State government owned or operated facilities.

uninsured patients, less payments received for those patients. States must consider UPL payments and other payments received on behalf of Medicaid and uninsured patients when calculating hospital-specific DSH payment limits.

### **North Carolina's Upper-Payment-Limit and Disproportionate Share Hospital Payment Process**

The North Carolina Department of Health and Human Services, Division of Medical Assistance (the State agency) is responsible for making UPL and DSH payments in accordance with the State plan. To ensure that these payments do not exceed the UPL or the DSH limits, effective September 1995, CMS required that North Carolina's State plan provide for a final cost settlement. The State plan established a two-step process for determining UPL and DSH payments. Step 1 involves estimating hospital costs based on prior-period cost reports. Using this estimate, the State makes UPL payments to hospitals. Also, the State makes estimated DSH payments to hospitals based on unreimbursed charges converted to costs. Step 2 involves a final cost settlement (via a cost report), which provides data to adjust these estimated payments to reflect current, actual costs. However, at the time of our review, North Carolina had not performed any final cost settlements since 1996.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

### **Objectives**

Our objectives were to determine whether North Carolina:

- calculated the UPLs for non-State government and private outpatient and 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**

North Carolina's State fiscal year (SFY) 2003 ended on June 30, 2003. Our review covered estimated UPL and DSH payments made during the period July 1, 2002, through March 31, 2003, which included the last quarter completed as of the start of our review. During this period, the State made estimated UPL payments of \$137 million (\$26 million outpatient and \$111 million inpatient) and estimated DSH payments of \$144 million. The State did not make any excess amount payments.

Because the State had not completed final cost settlements of the estimated payments made during our audit period, we were unable to determine whether the State made any UPL or DSH overpayments.

The objectives of our audit did not require an understanding or assessment of the overall internal control structure of North Carolina or the hospitals. Therefore, we did not perform any internal control reviews.

We performed fieldwork at the State agency in Raleigh, NC.

## **Methodology**

To accomplish our objectives, we:

- met with CMS regional office staff and reviewed their records pertaining to North Carolina's Medicaid program,
- interviewed key State agency personnel and reviewed the State's calculations for estimated UPL and DSH payments,
- reviewed Federal laws and regulations pertaining to UPL and DSH payments,
- compared Federal regulatory requirements with the methodology for calculating UPLs established in State plan amendments 00-017 (outpatient) and 00-13 (inpatient) for non-State government and private hospitals,
- reviewed classifications of hospitals to verify their inclusion in the proper category-specific UPL,
- reconciled to cost reports the Medicaid and Medicare cost data that North Carolina used to calculate the UPLs, and
- reviewed supporting records to determine whether North Carolina 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**

North Carolina calculated the SFY 2003 hospital outpatient UPLs in compliance with Federal regulations and the approved State plan amendment. However, North Carolina's calculation of the SFY 2003 hospital inpatient UPLs did not comply with its State plan amendment. As a result, during the first 9 months of SFY 2003, the State made unallowable hospital inpatient UPL payments of about \$42 million (\$26 million Federal share).

Also, North Carolina did not include UPL payments when calculating its SFY 2003 hospital-specific DSH limits and thereby inflated the DSH limits. As of the end of our

audit period, no DSH overpayment had occurred. Considering the impact of the excessive UPL payments, however, the potential DSH overpayment could have been at least \$42 million.

## **HOSPITAL INPATIENT UPPER-PAYMENT-LIMIT CALCULATIONS**

Section 1902 of the Act requires each State that establishes a Medicaid program to submit to CMS a State plan meeting all Federal requirements. Pursuant to section 1901 of the Act, a State must claim the costs of medical assistance in accordance with its approved State plan to receive Federal funding.

North Carolina's State plan amendment 00-13, as approved by CMS, required that estimated hospital inpatient UPL payments be based on costs incurred less payments received for Medicaid services as reported on the most recently filed cost reports. The State plan also adopted the revised UPL regulations (42 CFR § 447.272) and provided for final cost settlements of UPL payments.

North Carolina did not comply with its State plan amendment when it calculated the SFY 2003 hospital inpatient UPLs for non-State government and private facilities. From the inception of UPL payments in 1995 through June 30, 2002, the State used costs incurred as reported on recently filed hospital cost reports to determine the UPLs. However, effective July 1, 2002, the State changed its methodology for computing the inpatient UPLs and began using inpatient Medicaid charges converted to costs. Moreover, the State obtained these charges from its fiscal agent. CMS did not approve these changes.

North Carolina's use of charges instead of costs incurred inflated the estimated UPLs. Using SFY 2000 cost reports, we properly calculated the UPLs and compared them with the \$111 million in estimated inpatient UPL payments during the first 9 months of SFY 2003. The estimated payments exceeded the UPLs (using costs) by about \$42 million (\$26 million Federal share).

The \$42 million is subject to future adjustment. Determining the final figure would require a final cost settlement as required by the State plan, and cost report data needed to perform these settlements were not available. Although the final cost settlement process has been a State plan requirement since 1995, at the time of our review, no final cost settlements had occurred since 1996.<sup>3</sup> We have been informed that the State and CMS are working to resolve outstanding issues affecting the final cost settlements for UPL payments for all years since 1996.

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<sup>3</sup>The Office of Inspector General previously disclosed this matter in an April 30, 2003, report entitled "Review of North Carolina State Medicaid Agency Disproportionate Share Hospital Payments for Fiscal Years 1997 to 2001" (A-04-01-00003).

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

Section 1923(g) of the Act limits a hospital's Medicaid DSH payments to the costs of medical services provided to Medicaid and uninsured patients less payments received for those patients. In August 2002, a CMS policy clarification specified that States must include Medicaid UPL payments as a reduction of Medicaid and uninsured costs when calculating hospital-specific DSH limits. To ensure compliance with the Act, North Carolina's State plan provided for final cost settlements of DSH payments.

North Carolina did not include UPL payments in its calculation of SFY 2003 hospital-specific DSH limits. The State's calculation was based on its State plan, which limited estimated UPL payments to Medicaid cost deficits and limited estimated DSH payments to uninsured cost deficits. Thus, in the State's calculations, Medicaid cost deficits were attributable to Medicaid enrollees, whereas uninsured cost deficits were attributable to patients who were not enrolled in Medicaid or any other insurance. Because each form of payment was designated for different populations, the State believed that it did not need to offset UPL payments when calculating estimated DSH payments. However, DSH calculations must include UPL payments to comply with the Act.

The State's methodology inflated the hospital-specific DSH limits for SFY 2003. Based on payment data through March 2003, no DSH overpayment had occurred. However, if the State had made DSH payments up to the improperly calculated DSH limits at any time during the remainder of the fiscal year, an overpayment would have occurred. The potential overpayment would have been at least \$42 million considering the impact of the State's excessive UPL payments, as discussed earlier in this report.

We were unable to determine the final DSH overpayment without a final cost settlement of UPL and DSH payments as required by the State plan. The State and CMS are working to resolve outstanding issues affecting the final cost settlements for DSH payments for all years since 1996.

## **RECOMMENDATIONS**

We recommend that North Carolina:

- make future estimated inpatient UPL payments based on a UPL properly computed using Medicaid costs incurred instead of charges converted to costs;
- revise its calculation of hospital-specific DSH limits to include properly computed UPL payments; and
- resolve with CMS all outstanding issues affecting final cost settlements and, upon resolution, perform annual final cost settlements and refund the Federal share of any UPL and DSH overpayments.

## **STATE'S COMMENTS AND OFFICE OF INSPECTOR GENERAL'S RESPONSE**

In its comments on the draft report, the State did not specifically address our first two recommendations. With respect to the third recommendation, the State said that any action must await the conclusion of discussions with CMS to resolve several technical and legal issues. Based on the State's comments, we modified this recommendation. As our report indicates, it is not yet possible to determine final overpayment amounts because the State has not performed final cost settlements.

The State's comments are included in their entirety as an appendix to this report. A summary of those comments, along with our response, follows.

### **Executive Summary**

#### **State's Comments**

The State asserted that the Executive Summary of our report contained contradictory statements. Under the "UPL Calculations" caption, the report noted that the State made unallowable UPL payments of about \$42 million. However, under the "Calculation of Hospital-Specific DSH Limits" caption, the report stated that as of the end of the audit period, no overpayment had occurred.

#### **Office of Inspector General's Response**

The statements cited by the State address two separate issues and are not contradictory. The first statement accurately disclosed that the State made unallowable UPL payments of about \$42 million during the first 9 months of SFY 2003. The second statement concerned DSH payments, not UPL payments, and was part of a paragraph indicating that although no DSH overpayment had occurred as of the end of the audit period, the State's continued use of its current method to calculate DSH limits could have led to a DSH overpayment by the end of SFY 2003.

### **Hospital Inpatient Upper-Payment-Limit Calculations**

#### **State's Comments**

According to the State, our disclosure of its use of inpatient Medicaid charges converted to costs, instead of costs obtained from hospital cost reports, was misleading. The State said that it had always intended to base payments to health care providers on the most current and accurate information available. When CMS delayed the filing of Medicare and Medicaid hospital cost reports, the State's use of the September 2000 cost reports was delayed until May 2002. Because CMS delayed the filing of hospital cost reports, the State chose to estimate costs using Medicaid paid claims data. The State said that these data represented the most current and accurate information available.

## **Office of Inspector General's Response**

Our disclosure of the State's use of inpatient Medicaid charges converted to costs was not misleading; it was factual. In addition, using Medicaid charges converted to costs was in direct conflict with the approved State plan.

We acknowledge that CMS delayed the filing of the September 30, 2000, yearend Medicare cost reports until May 27, 2002. However, the 2000 cost reports were required to be filed with CMS over a month before the State changed its UPL methodology in July 2002. Therefore, when the State adopted the new methodology that was contrary to its State plan, the State's 2000 cost data were available. However, the State chose not to use those data.

## **Calculation of Hospital-Specific Disproportionate Share Limits**

### **State's Comments**

The State acknowledged that the "test for Hospital Specific DSH limits" did not appear to have been included as part of the interim payment calculations. However, the State did not agree that it had exceeded the DSH limits. The State said that it contracted with a consultant to assist with DSH payment calculations beginning with the final period of Federal fiscal year 2003 and that the final DSH payment for that year included all DSH and supplemental interim payments. Using this information, the State believed that it accurately calculated the hospital-specific DSH limit for each hospital for the full period of Federal fiscal year 2003. Moreover, the State noted that these payments were subject to settlement.

### **Office of Inspector General's Response**

The State provided no additional evidence that it properly calculated the DSH limits. We did not evaluate the consultant's results, which covered DSH payments beyond our audit period. For our audit period, the amounts we reported are accurate; however, we acknowledge that they are subject to future final settlement.

# **APPENDIX**



North Carolina Department of Health and Human Services  
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Tel 919-733-4534 • Fax 919-715-4645

Michael F. Easley, Governor

Carmen Hooker Odom, Secretary

March 31, 2005

Mr. John T. Drake  
Acting Regional Inspector General for  
Audit Services, Region IV  
61 Forsythe Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

Dear Mr. Drake:

Thank you for the opportunity to respond to the draft report entitled, *Review of North Carolina's Medicaid Upper Payment Limit Calculations* (Report Number: A-04-03-02028)

The State of North Carolina would like the following comments and observations to be considered by the Office of Inspector General as the review is finalized for the North Carolina's Medicaid Upper Payment Limit Calculation report.

1. Executive Summary, Summary of Findings, Page ii
  - a. The draft report states under the UPL Calculation header that, "*As a result, during our audit period (the first 9 months of SFY 2003), the State made unallowable hospital inpatient UPL payments of about \$42 million.*" Yet under the subject header Calculation of Hospital-Specific DSH Limits it states, "*As of the end of the audit period, no overpayment had occurred.*" These two observations are contradictory. If the assertion is that an overpayment occurred, we respectfully request a copy of your analysis which supports this conclusion, so that we can fully review your findings and provide you with our comments. If you believe (as we do) that no overpayments were made, we request that you remove from the report any statement to the contrary.
  - b. Other items in the Executive Summary are naturally extracted from the text of the full draft report. The State requests that upon review and consideration of our comments below, changes be made as necessary to both the Executive Summary and the final report.
2. Draft Report, Hospital Inpatient UPL Calculations, Page 4
  - a. This section states "*the State plan required that estimated UPL payments be based on costs incurred for hospital inpatient services and that these costs be obtained from the most recently filed hospital cost reports. Instead of using costs incurred as reported on hospital cost reports, in July 2002, the State began using inpatient Medicaid charges converted to costs as obtained from its fiscal agent. CMS did not approve this change.*"

We believe this paragraph is misleading. One could easily conclude after reading this paragraph that the State of North Carolina arbitrarily chose to switch from using cost report data to paid claims data, and that this switch was designed to inappropriately increase Medicaid payments; however, this is incorrect.

We request the following facts be incorporated into your report:

1. The North Carolina Medicaid program has adopted the Medicare cost report (Form CMS 2552-96) and Medicare's cost report timing filing requirements.
2. CMS issued Program Memorandum – Transmittal A-01-117 on September 26, 2001, informing its fiscal agents (and Medicare hospital providers) that cost report filing deadlines would be extended due to Medicare's inability to develop and issue PS&R reports for HHA and outpatient hospital services.
3. The majority of North Carolina hospitals have a September year-end. As such, this transmittal delayed the filing of the September 30, 2000, Medicaid and Medicare cost reports until February 17, 2002.
4. Hospital cost report filing requirements were further delayed through Transmittal A-01-149. In this transmittal CMS delayed the filing requirements for hospitals with September 30, 2000 year-ends until May 27, 2002.
5. Without these delays, Medicaid would have received the September 30, 2000 cost reports on or about February 28, 2001. Therefore, CMS delayed North Carolina Medicaid's receipt of the 2000 cost report by over one year.
6. The period of the time subject to the OIG UPL audit started July 1, 2002.

It has always been the North Carolina Medicaid program's intention to base payments to health care providers on the most current and accurate information available. When CMS decided to delay the required filing of Medicare and Medicaid hospital cost reports, the agency was faced with two alternatives: (1) to continue to use older cost reports or (2) to estimate cost using current Medicaid paid claims data and then convert covered charges to costs. The State agency chose the second option, since it represented the most current and accurate information available to it. The agency finds it problematic that one unit of the federal government (CMS) could delay timely receipt of hospital cost report data, and then another unit of the federal government (OIG) could assert that the agency's use of an alternative data source was anything but appropriate.

3. Draft Report, Calculation of Hospital-Specific DSH Limits, Pages 4-5
  - a. This section states "*North Carolina did not include UPL payments in its calculation of SFY 2003 hospital specific DSH limits.*"

It does not appear that the test for Hospital Specific DSH limits was included as part of the interim payment calculations reviewed during the audit period; however, we do not agree that hospitals' DSH limits were exceeded. Beginning with the final period of Federal Fiscal Year 2003, DMA contracted with its

consultant, Tucker-Allen/Navigant, to assist DMA with DSH payment model calculations. As a result, the final DSH payment period for FFY2003 covered the last two quarters of FFY2003 and included all DSH and Supplemental interim payments. Using this information, DMA accurately calculated the hospital-specific DSH limit for each hospital for the full period FFY 2003. Moreover, North Carolina's DSH and Supplemental Payments are subject to settlement and the Hospital-specific DSH test will be calculated as part of the settlement. DMA also incorporated this test into the year-end FFY 2004 interim payment calculations

4. Draft Report, Recommendations, Page 5

- a. The final recommendation listed is for North Carolina to perform annual settlements for UPL and DSH payments as required by the State plan and refund any overpayments or appropriate Federal share.

As acknowledged by the OIG in the draft report, North Carolina is still in discussions with the Centers for Medicare and Medicaid Services (CMS) to reach a final resolution on several technical and legal issues regarding federal law and interpretation of North Carolina's State Plan language. Until discussions with CMS are concluded and a final interpretation reached, it is not possible to determine if the payments to providers actually exceeded the aggregate UPL, and if so, by what amount. As there are significant dollar amounts at issue, to comply with an arbitrary OIG deadline for resolving these issues and performance of cost settlements would not serve the public interest and could adversely affect health care delivery in North Carolina.

Again, we thank you for the allowing the Department additional time to respond to the draft report and for considering the above comments before finalizing the draft report.

Sincerely,



Carmen Hooker Odom

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