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S. Kimberly Belshé, Secretary
Health and Human Services Agency
1600 Ninth Street, Suite 460
Sacramento, California 95814

Dear Ms. Belshé:

This letter presents the results of a review by the Bureau of State Audits (bureau) of the new reimbursement rate system used by the Department of Health Services (Health Services)[1] to reimburse skilled nursing facilities (facilities). Our initial audit report issued in February 2007 stated that we could not verify that calculations of the new reimbursement rates were appropriate because Health Services had not adequately documented its methodology. As a result, we asked Health Services to provide us with formal, detailed documentation of all the complexities of the rate development methodology.

After reviewing the documented methodology that Health Services subsequently provided, we concluded that Health Services' calculations of the fiscal year 2005–06 rates for 1,016 freestanding facilities, which are not attached to hospitals, and have a level-B California Medical Assistance (Medi-Cal) program rating under Assembly Bill 1629 (standard facilities) complied with the law and had been appropriately implemented. In addition, we found no material discrepancies with the reimbursement rate calculation for 28 facilities that provide subacute services.

Background

This letter presents the results of the second of a two-part audit the bureau conducted concerning Health Services' implementation of legislation intended to improve the quality of care in facilities. In our initial report issued in February 2007, *Department of Health Services: It Has Not Yet Fully Implemented Legislation Intended to Improve the Quality of Care in Skilled Nursing Facilities* (2006-035), we reported that because Health Services had not adequately documented its methodology, we could not verify the accuracy of its reimbursement rate calculations. We requested that Health Services, in its 60-day response, provide us with formal documentation detailing all the complexities of its reimbursement rate methodology. After Health Services met our request, we proceeded with our evaluation.

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[1] On July 1, 2007, the Department of Health Services became the California Department of Health Care Services. However, for purposes of this letter, we use the former department name.

Health Services administers the Medi-Cal program, the State's Medicaid program. The Medi-Cal program is funded and administered through a state and federal partnership to benefit low-income people who do not have health insurance, including low-income families with children and persons on Supplemental Security Income who are aged, blind, or disabled.

The Long-Term Care System Development Unit (Development Unit) and the Long-Term Care Reimbursement Unit (Reimbursement Unit) within Health Services conducts an annual study to develop the Medi-Cal rates for long-term care providers. That study serves as the basis for Medi-Cal reimbursements of approximately $3 billion annually for facilities, intermediate care facilities for the developmentally disabled, hospice care, adult day health care, and home health agency services. The Reimbursement Unit also conducts research to develop or revise reimbursement methodologies as needed to meet changing policy or program needs.

Currently, about 1,300 facilities in the State provide services to patients covered by Medi-Cal. Until the passage of the Skilled Nursing Facility Quality Assurance Fee and Medi-Cal Long-Term Care Reimbursement Act (Reimbursement Act) in September 2004, facilities received reimbursements for Medi-Cal services based on a flat rate. The Reimbursement Act required Health Services to implement a modified reimbursement rate methodology that reimburses each facility based on its costs. In passing the Reimbursement Act, the Legislature intended the cost-based reimbursement rates to expand individuals' access to long-term care, raise the quality of that care, and promote decent wages for facility workers. The Reimbursement Act also imposed a Quality Assurance Fee on facilities to provide a revenue stream that would enhance federal financial participation in the Medi-Cal program, increase reimbursements to facilities, and support facilities' efforts to improve the quality of care. This letter, in addition to our initial report issued in February 2007, discusses Health Services' progress in carrying out the provisions of the Reimbursement Act.

Health Services Appropriately Calculated the Fiscal Year 2005–06 Reimbursement Rates and Properly Implemented Them

The Reimbursement Act directs the bureau to review Health Services' new facility-specific reimbursement rate system. Health Services uses a separate reimbursement rate calculation for each facility type. As indicated in our initial report, we reviewed Health Services' reimbursement methodology to ensure that it included the cost components specified in the Reimbursement Act. For fiscal year 2005–06, Health Services calculated rates for 1,016 standard facilities and 28 subacute facilities. To determine if Health Services appropriately calculated the facility-specific reimbursement rates and properly implemented them, we performed various procedures for standard facilities and for subacute facilities.

For both standard facilities and subacute facilities, we conducted tests to determine if Health Services used reliable data to calculate the rates, if the system appropriately manipulated those data, and whether Health Services properly implemented the resulting facility-specific rates.

Testing of Standard Facility Rates Revealed Only Inconsequential Errors in Implementing the Facility-Specific Reimbursement Rates

After performing the three tests for the reimbursement rates applied to standard facilities, we found no significant problems in data reliability or the system manipulations of the data. However, when determining if Health Services properly implemented the facility-specific reimbursement rates, we found that the reimbursement rates it publishes are not updated when reimbursement rates are revised. Furthermore, we found Health Services' contractor, Electronic Data Systems (EDS), claims examiners made processing errors that resulted in overpayments.

To determine if Health Services used reliable data to calculate the rates, we performed various tests, including randomly sampling at least 29 records. Among the records we reviewed were approximately 20 tables containing data that Health Services used to calculate the rate for each facility. We traced our sample records back to source documents, including expenses in facility audit reports, data collected and maintained by the Office of Statewide Health Planning and Development (OSHPD), and inflation factors developed by Health Services based on its labor study. The data elements included, but were not limited to, salaries, benefits, administrative costs, caregiver training, professional liability insurance, licensing fees, and labor inflation factors.

We tested the sample records from each table and found no material errors. For a sample size of 29 at a 95 percent confidence level, this result indicates that the error rate did not exceed 10 percent. Testing the correctness of the amounts in the audit reports, testing the correctness of the OSHPD data, and verifying the accuracy of Health Services' labor study were not within the scope of this audit.

To determine if the system appropriately manipulated the data for standard facilities, we independently calculated the reimbursement rate for each of the 1,016 standard facilities and compared the results with Health Services' published rates. This comparison revealed only inconsequential and isolated errors. Health Services had an error in its calculation formula, causing it to incorrectly apply an allocation statistic to two cost categories when each should have had its own allocation statistic. However, according to an analysis performed by Health Services, the effect of that error was minimal and had no material effect on the final calculation.

To determine if Health Services properly implemented the facility-specific reimbursement rates for standard facilities, we compared the resulting rates with the rates EDS applied to Medi-Cal claims submitted by standard facilities. For two million payments totaling $2.5 billion, we took the amount Health Services should have paid and compared it to the amount Health Services actually paid. Of the $2.5 billion in payments, we found that $1 million was paid to facilities in excess of the published rate.

We judgmentally selected 10 payments for review, ensuring that the selected payments related to most of the $1 million that was paid to facilities in excess of the published rate. Five of the 10 were overpayments that resulted from processing errors caused by EDS claims examiners.

Together, these five overpayments resulted in a total of $6,446 in overpayments to providers. A sixth payment was specific to one facility that had received 114 similar payments; the total for the 115 payments was $82,362. Although EDS data for this facility indicate that all the payments were subject to a 25 percent penalty, the facility received full payments. After further investigation, EDS staff found that the provider originally supplied an incorrect billing code, which was later corrected, and that full payments were proper.

The remaining four payments we reviewed were rate discrepancies associated with four standard facilities and related to 4,498 other payments. When we compared the amount Health Services should have paid with the amount that it actually paid, the total of the differences for the 4,502 payments was $655,976. These discrepancies arose because of a problem with documenting rate changes that, in our initial report, we described and made a recommendation for correction. EDS correctly authorized and made payments for the 4,502 claims using Health Services' revised rates. However, the revised rates were different from those Health Services had published. We did not analyze the remaining rate differences resulting in approximately $255,216 in payments in excess of the published rates.

No Significant Errors Were Found in Rates Applied to Subacute Facilities

For subacute facilities, we conducted the same tests as we did for standard facilities. Following our testing, we concluded that Health Services used reliable data, the system manipulated the data correctly, and Health Services implemented the rates correctly.

To determine if Health Services used reliable data to calculate rates for subacute facilities, we limited our testing to the 34 data elements from facilities' audited financial reports. These data elements supported much of the rate calculation. For one of the 28 facilities, we traced each data element to its audit report and found no errors. For the remaining 27 facilities, we randomly selected one data element from each facility and traced it to an audit report. Again, we found no errors.

To determine if the system appropriately manipulated the data, we reviewed the formulas for compliance with the approved methodology and found no inconsistencies.

To determine if Health Services properly implemented the facility-specific rates, we compared the resulting rates with those that EDS applied to Medi-Cal claims submitted by subacute facilities and found no material errors.

The U.S. Government Accountability Office, whose standards we follow, requires us to assess the reliability of certain computer-processed data. Based on our testing, we determined that the data Health Services used to calculate the reimbursement rates were sufficiently reliable for the purposes of this audit. Likewise, our testing led us to conclude that the EDS payment data were sufficiently reliable for the purposes of this audit. We determined that using the data for the purposes of this audit would not lead to an incorrect or unintentional message.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in this letter.

If you have any questions or concerns, please contact Michelle Baur, IT Audits Manager, at (916) 445-0255.

Sincerely,

ELAINE M. HOWLE
State Auditor

cc: Sandra Shewry, Director, Department of Health Care Services