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**North Carolina Department of Health and Human Services**

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Michael F. Easley, Governor

Carmen Hooker Odom, Secretary

November 1, 2006

Lynn Muchmore, Director  
Fiscal Research Division  
Room 619, Legislative Office Building  
Raleigh, NC 27603

Dear Mr. Muchmore:

As directed by Senate Bill 1741§10.11.(c), the North Carolina Department of Health and Human Services Office of the Internal Auditor (OIA) and Division of Medical Assistance (DMA) have conducted a study as to the advisability of rebasing the skilled nursing facility reimbursement system. In response to Senate Bill 1741, the study had as its objectives:

- a) Document key parameters that determine reimbursement rates for skilled nursing facilities,
- b) Determine whether rebasing at the present time is appropriate based on data analysis and considering all available information, and
- c) Ascertain "lessons learned" to strengthen the process by which reimbursement rates are set.

To accomplish these objectives, DMA's Rate Setting Section and the Audit Section under the review of the Office of the Internal Auditor completed the following tasks:

1. The rate reimbursement model was analyzed and the model's components were updated to reflect FY 2004 cost data and the providers' current case mix indices (CMI).
2. In an attempt to validate FY 2004 cost data submitted by providers, the firm of Clifton Gunderson LLP, under the direction of the DMA Audit Section, conducted seven field reviews. Significant adjustments to the reported costs were required as a result of the field audits.
3. The FY 2006 case mix indices data was imported into the rate model. Part of the ongoing process is a validation review performed by Myers and Stauffer LC under the direction of DMA. MDS data is the basis by which the case mix indices are determined and directly affects the amount paid to providers. The purpose of these reviews is to determine whether the reported CMI is supported by clinical documentation.
4. The OIA then analyzed and validated DMA's work and the study's conclusions.



### Conclusion

Based upon the review of the FY 2004 cost data and FY 2006 CMI data, the department has concluded that it would be premature to rebase rates at this time for the following reasons:

1. The 2004 fiscal year cost data reported by providers are not accurate. The primary reason for this condition is that FY 2004 was the first cost reporting year for which the new CMI reimbursement and health care assessment methodology was in effect. Since the State Plan Amendment was retroactively approved by CMS six months into the cost reporting year, it is reasonable to assume that the FY2004 cost report cycle does not satisfactorily represent nursing home operating expenses that were and will be incurred under the new CMI based methodology.
2. The 2004 fiscal year cost data is significantly overstated. Due to the types of cost report discrepancies noted during the FY 2004 field reviews, we are of the opinion that the FY 2004 cost data previously submitted by providers is overstated and that subsequent adjustments are necessary to correct the overstatements. Any rebasing should be done utilizing the most accurate audited information available. Field audits on FY 2005 cost reports are anticipated to be completed the latter part of 2007.

The 2005 MDS data reflected that providers overstated the acuity levels of their facilities. FY 2004 and FY 2005 MDS data was reviewed by Myers and Stauffer LC for the purpose of educating the providers in the review process. The department began reviewing the MDS data October 1, 2005, for the purpose of adjusting the CMIs and reimbursement rates. Based upon the current reviews, starting with the June 30, 2005 MDS data, approximately thirty percent of the providers have overstated the acuity level of their nursing facility residents. The overstatement has a direct impact on the CMI rate setting calculation and has resulted in a two million dollar payback to the Medicaid program; thereby, clearly indicating that the MDS data was not documented accurately. We are of the opinion that additional time will be required for providers to gain the requisite level of expertise needed to accurately judge the acuity level of their residents.

DHHS feels strongly that it is advisable to validate cost and MDS data submitted by providers before developing new reimbursement rates. In order to use the most complete information available, the department will rebase using FY 2005 cost data upon completion of field audits. As previously stated, the field audits are anticipated to be completed during the latter part of 2007. It is also anticipated that the rebase would be implemented effective October 1, 2007.

Respectfully submitted,

  
Carmen Hooker Odom

CHO:ds

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