

CALIFORNIA DEPARTMENT OF CORRECTIONS

It Needs to Ensure That All Medical Service Contracts It Enters Are in the State's Best Interest and All Medical Claims It Pays Are Valid

Audit Highlights . . .

Our review of the California Department of Corrections' (Corrections) processes to contract for health care services not currently available within its own facilities concludes that:

- Corrections staff who negotiate contracts tend to rely on a 30-year-old state policy exemption that allows them to award contracts for most medical services without seeking competitive bids.***
- Corrections' negotiation practices are flawed. For example, some of the Health Care Services Division's and prisons' hospital contracts leave out information vital to ensuring that the State receives discounts those contracts specify.***
- Corrections is unable to justify awarding contracts for rates above its standards, violating this requirement of Corrections' contract manual.***
- Corrections sometimes exceeds the authorized contract amount and fails to obtain proper approvals before receiving nonemergency services.***

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California Departments of General Services' and Corrections' responses as of October 2004

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to examine the process that the California Department of Corrections (Corrections) uses to contract for health care services not currently available within its own facilities. Specifically, the audit committee directed the bureau to examine the process Corrections uses to negotiate contracts for outside health care services, including the different types of agreements it enters, its fees schedules, the roles of headquarters and prisons, and the qualifications of its negotiation staff. Further, the audit committee instructed the bureau to select a sample of contracts for outside health care services, including hospitals in both rural and urban areas, to determine whether Corrections negotiated the best value for the services, whether rates in rural and urban areas are comparable for similar services, whether rates for similar services are comparable to those under the State's Medicaid Assistance program (Medi-Cal), and whether Corrections employs data on trends of volume and average use of contracted medical services to obtain price breaks or quantity discounts. The audit committee also asked the bureau to review Corrections' policies and procedures for processing and monitoring claims for contracted health care services to determine if Corrections verifies the validity of the claims. Finally, the audit committee requested the bureau to evaluate Corrections' implementation of certain recommendations outlined in the bureau's report titled *California Department of Corrections: Utilizing Managed Care Practices Could Ensure More Cost-Effective and Standardized Health Care*, issued in January 2000.

☑ *Corrections' prisons are not adhering to its utilization management program, established to ensure inmates receive quality care at contained costs. Consequently, prisons are overpaying for some services, incurring unnecessary costs for the State.*

Finding #1: Corrections' reliance on a long-standing policy exemption to competitive bidding for medical services may not be in the State's best interest.

Corrections staff who negotiate contracts tend to rely on a 30-year old state policy exemption that allows them to award contracts for most medical services without seeking competitive bids.

We recommended that the California Department of General Services (General Services) consider removing its long-standing policy exemption that allows Corrections to award, without advertising or competitive bidding, medical service contracts with physicians, medical groups, local community hospitals, 911 emergency ambulance service providers, and an ambulance service provider serving a single geographical area.

If General Services decides that it is not in the State's best interest to remove the long-standing policy exemption, it should prescribe the methods and criteria for Corrections to use in determining the reasonableness of contract costs as follows:

- Require Corrections to undertake procedures similar to those required in the noncompetitively bid (NCB) process. Specifically, it should require Corrections to conduct a market survey and prepare a price analysis to demonstrate that the contract is in the State's best interest.
- Require Corrections to obtain approval of its market survey and price analysis from its director before submitting this information along with its contract to General Services for approval.

Department Action: Corrective action taken.

General Services completed its analysis of information obtained through a survey and meetings with various state departments that have historically used the medical services bidding exemption to award certain contracts. General Services has concluded that it is not in the best interest of the State to retain its long-standing policy exemption. Specifically, on January 26, 2005, General Services issued Management Memo number 05-04, which establishes a new statewide policy and requirements regarding medical services contracts. The Management Memo directs departments to employ the competitive bidding process to the maximum extent possible and requires that the director of General Services (or his/her designee) determine whether to grant

bidding exemptions. The Management Memo does not require competitive bidding for the following: (1) contracts for ambulance services (including but not limited to 911) when there is no competition because contractors are designated by a local jurisdiction for the specific geographic region, and (2) contracts for emergency room hospitals, and medical groups, physicians, and ancillary staff providing services at emergency room hospitals, when a patient is transported to a designated emergency room hospital for the immediate preservation of life and limb and there is no competition because the emergency room hospital is designated by a local emergency medical services agency and medical staffing is designated by the hospital. This exemption covers only those services provided in response to the emergency room transport.

Finding #2: Corrections has negotiated and awarded many hospital contracts that omit schedules to verify hospital charges are appropriate.

The compensation terms of some hospital contracts we reviewed do not include the information needed to evaluate potential costs and determine that hospital charges are consistent with contract terms. Also, for two contracts that had contract terms stipulating that the hospitals supply copies of their rate schedules (charge masters), Corrections staff failed to obtain them.

Beginning July 1, 2004, a new state law will require hospitals to file copies of their charge masters annually with the Office of Statewide Health Planning and Development.

We recommended that Corrections work with the Office of Statewide Health Planning and Development to obtain hospitals' charge masters, and use this information to negotiate contract rates and obtain discounts specified in the contracts.

Department Action: Corrective action taken.

Corrections reported that it met with the Office of Statewide Health Planning and Development and they developed procedures that will allow Corrections to obtain hospital charge description masters (CDM) annually, beginning in July 2005, for each hospital it contracts with. In the interim, Corrections is requesting CDMs for existing and all renewals of existing hospital contracts prior to negotiating hospital contracts.

Finding #3: Corrections cannot show that it follows procedures it developed to ensure that rates exceeding its standard rates are favorable.

The mission of Corrections' Health Care Services Division (HCSD) is to manage and deliver to the State's inmate population health care consistent with adopted standards for quality and scope of services within a custodial environment. The HCSD does not always ensure that prisons negotiate favorable rates. Until Corrections modifies and enforces its procedures to evaluate the reasonableness of proposed rates that exceed its standards, it will continue to undermine the State's goal of obtaining favorable rates.

In addition, Corrections lacks procedures to address instances when HCSD initiates a rate exemption. According to HCSD, its analysts essentially apply the same standards that prisons must follow and require the signature of the assistant deputy director. Yet, we identified four instances of HCSD not providing analyses to justify its approval of higher rates.

We recommended that Corrections ensure that HCSD enforces rate exemption requirements, including obtaining and reviewing documentation to verify prisons' justification for higher rates.

We also recommended that Corrections establish procedures to ensure that the rate exemptions initiated by HCSD undergo an independent review and higher-level approval process.

Department Action: Partial corrective action taken.

Corrections reported that its HCSD is currently enforcing rate exemption requirements by reviewing all medical contract rates to ensure they meet rate exemption requirements. Analysts prepare written documentation and analysis of rate exemption requests and submit them for approval from the deputy director, HCSD. The written analysis addresses the need for the contract, communications regarding rate negotiations, comparisons with other contracts statewide, and review of utilization data and project costs. Corrections also indicated that it is in the process of developing a new rate approval process to replace its existing Request for Medical Rate Exemption process. The new process is being tested to ensure that all elements required are incorporated into the form and Corrections plans were to have the new process implemented by November 2004.

Corrections stated it believes its existing approval levels for rate exemptions initiated by HCSD staff are appropriate and consider the best interest of the State by providing a review of medical contracts for fiscal prudence and, equally important, clinical appropriateness. However, Corrections response is inconsistent with information Corrections' representatives presented in the Assembly Budget Pre-Hearing held in April 2004. Corrections' staff indicated that it would be possible for staff with accounting or financial expertise, in a division other than HCSD, to review the medical contracts for fiscal prudence.

Corrections also reported that it is in the process of contracting for additional services from an expert in health care contract negotiations that will provide financial and technical expertise to improve contract rates and its negotiation process. Corrections anticipates that it will have the contract in place by the end of fiscal year 2004–05.

Finding #4: Corrections cannot demonstrate it uses historical data when negotiating contracts.

Corrections cannot show that it routinely uses cost and utilization data to negotiate contract rates. Without documentation to show that it employed cost and utilization data, it cannot display a thorough and good-faith effort to protect the State's interest.

We recommended that Corrections adopt procedures that require staff to consider cost and utilization data when negotiating medical service contracts. These procedures should also require staff to document the use of these data in the contract file.

Department Action: Corrective action taken.

Corrections stated that it verbally instructed the Health Contracts Services Unit (HCSU) staff in April 2004 to review utilization data. Also, in July 2004, HCSU initiated a final written procedure that requires staff that negotiate medical services contracts to consider utilization data. As part of the contract request review process, HCSU is required to routinely review utilization data to determine if the contract is necessary and cost effective, or if services can be provided through another existing contract. Further, the procedure requires that staff document the use of the utilization data in the contract file. Finally, effective July 2004, HCSU directed field staff to submit all contract requests to it first for approval, rather than the Office of Contract Services.

Finding #5: Negotiation staff could benefit from specialized training.

Staff at both HCSD and the prisons have varying degrees of expertise in negotiating rates in contracts with medical service providers. Because prison staff who negotiate the terms and conditions of contracts for medical services at the prisons have uneven levels of contracting ability, the contracting and negotiating practices throughout the State are inconsistent.

We recommended that Corrections ensure that HCSD offers specialized training for its negotiation staff so they can effectively negotiate favorable rates. HCSD should then share any strategies and techniques with the prisons' negotiation staff.

Department Action: Partial corrective action taken.

Corrections reported that its HCSU staff completed analytical skills training and some staff also completed cost benefit analysis and negotiation skills workshops. The remainder of HCSU staff are scheduled to complete these workshops by April 2005. Further, as previously mentioned, HCSD is in the process of contracting for additional services from an expert in health care contract negotiations.

Finding #6: Corrections' hospital expenses vary widely according to the compensation method.

We found that Corrections negotiates various compensation methods for hospital services, such as per diem rates or flat percentage discounts. Generally, Corrections can get substantially better rates when paying a per diem rate than when paying a flat discount rate.

We recommended that Corrections ensure that HCSD tries to obtain per diem rates as a compensation method when negotiating hospital contracts. Additionally, HCSD should document its attempts to obtain per diem rates.

Department Action: Partial corrective action taken.

Corrections reported that HCSU staff were directed to document efforts to obtain per diem rates as part of the negotiation process in each contract file. Corrections plans to incorporate this directive into the HCSU policy and procedures scheduled to be developed by July 2005. Also,

beginning in January 2005, the HCSU staff will track in a database efforts to secure per diem rates for new and renewing hospital contracts.

Finding #7: HCSD and prisons have not submitted many medical service contracts to Corrections' Office of Contract Services' (Contract Services) Institution Contract Section (ICS) within required time frames.

We found that prisons and HCSD submitted late contract or amendment requests for 14 of 56 contracts we reviewed. Specifically, we found that ICS approved 5 of 14 requests even though the requests did not appear to meet the criteria allowed by Corrections' policy memo. In addition, the policy memo requires Contract Services to generate a quarterly report card outlining all late contract and amendment requests and to distribute a copy of the report card to its division deputies. However, we found that Contract Services does not use the report cards, thereby missing an opportunity to use the report cards to enforce compliance with Corrections' policy.

We recommended that Corrections direct ICS to evaluate late requests using the criteria outlined in the policy memorandum. Additionally, ICS should request HCSD and the prisons to provide relevant documentation to support their requests.

We also recommended that Corrections continue generating report cards periodically and establish procedures for staff such as prisons' associate wardens to submit corrective action plans to Contract Services to monitor.

Department Action: Partial corrective action taken.

Corrections reported that the ICS continues to evaluate each request utilizing the established criteria outlined in the policy memorandum and approves requests that are substantiated and deemed to be in the best interest of the State and or/ contractor. If prisons do not provide sufficient information to support a late justification, ICS will request additional information. ICS will deny late submittal justifications that are not substantiated and return them to the prisons' health care manager with an explanation for the denial and instructions to direct the contractor to seek payment through the Board of Control process. ICS will also send a copy of the denial notification to HCSU. Late submittal justifications that are substantiated are approved at the section chief level.

Corrections stated that the OCS continues to generate the report cards semi-annually and distributes them to the chief deputy directors, deputy directors, assistant directors, Institution and Health Care Services regional administrators, and wardens. OCS has added a summary displaying data shared with management for two prior reporting periods. The additional summary will enable program or institution management to determine if improvements have been made or if a pattern of lateness continues. Corrections has instructed the programs and institutions to utilize this data to assist in their efforts to reduce late contract requests. Corrections is currently developing procedures that include the submission of corrective action plans to OCS for monitoring. Corrections plans to implement these procedures by January 31, 2005.

Finding #8: Corrections does not always ensure that authorized prison spending remains within authorized contract amounts.

For four contracts, the prisons were given spending authority via their notice to proceed (NTP) process by ICS that exceeded the contract amounts by \$5.9 million.

We recommended that Corrections ensure that ICS staff review the master contract and outstanding NTPs before issuing additional NTPs so that it does not exceed the master contract amount.

Department Action: Corrective action taken.

Corrections reported that it has corrected the errors identified and modified its procedures. It also stated that ICS would train staff, on an ongoing basis, to follow guidelines established in its Master Contract Procedures and would also conduct random audits of master contracts to ensure compliance with the procedures.

Finding #9: Some medical services are rendered before General Services approves the contracts.

We identified five contracts where services were rendered between 15 and 134 calendar days before Corrections obtained General Services' approval.

We recommended that Corrections evaluate its contract-processing system to identify ways for HCSD, ICS, and the prisons to eliminate delays in processing contracts and avoid allowing contractors to begin work before the contract is approved.

Department Action: Corrective action taken.

Corrections reported that OCS issued a new late submittal policy for contracts and amendments in June 2004, stressing the importance of timely submission and the risks involved when contractors provide services without a contract. ICS and HCSD continue to meet regularly to develop strategies to reduce the number of late contracts submitted by prisons. Corrections also reported that, on an ongoing basis, OCS would consider alternatives to reduce the number of late contracts.

Finding #10: ICS does not always require prisons to demonstrate the unavailability of medical registry contractors before approving their contract requests.

ICS is responsible for awarding and managing medical registry contracts but does not always verify that the prison made an effort to obtain the required services from a provider included in a medical registry contract before approving a prison's request for a contract with a nonregistry provider. Failure to document attempts to contact registry providers exposes the State to potential lawsuits from registry contractors for breach of contract terms and hinders ICS' ability to terminate the registry provider for nonperformance.

We recommended that Corrections modify its procedures to require prisons to submit documentation to ICS demonstrating their attempts to obtain services from registry contractors with their requests for services from a nonregistry contractor.

We also recommended that Corrections direct ICS to review prisons' documentation and ensure that prisons have made sufficient attempts to obtain services from registry contractors. ICS should use these data to identify trends of nonperformance and terminate registry providers, when necessary.

Department Action: Corrective action taken.

Corrections stated that the OCS issued a memorandum in April 2004 implementing a new policy requiring programs to submit documentation of their attempts to contact

contractors to obtain services before requesting additional contracts for services covered under existing contracts. OCS also developed forms to assist prisons in documenting their contacts and requires prisons to submit this documentation with their contract requests.

Corrections reported that ICS currently reviews prisons' documented efforts to obtain services from registry providers to ensure compliance with contract terms and conditions before processing additional contracts for services. If prisons do not provide documentation of their efforts, they are instructed to contact current registry providers and document efforts before resubmitting their contract requests. ICS and HCSD collectively review the documentation to determine if multiple prisons are being denied services by a contractor and will terminate the contract if it is deemed in the best interest of the State.

Finding #11: Corrections continues to significantly increase its use of medical registry contracts.

Corrections' use of medical registry contracts is the fastest growing component of contracted medical services. We found that Corrections has attempted to reduce registry expenditures by numerous efforts to recruit medical staff and requesting funding to establish additional positions.

We recommended that Corrections continue to monitor prisons' registry expenditures on a monthly basis and evaluate their need for services.

Department Action: Partial corrective action taken.

Corrections reported that it initiated a new process in July 2004 designed to evaluate usage and need of registries periodically. Specifically, HCSD's Financial Management Unit provides a copy of the vacancies versus registry report to the Health Care regional administrators and managers each month. Also, HCSD has established a process to regularly analyze and discuss the usage of registry contracts with the health care managers through their monthly budget review process. Due to the limited amount of data available, any savings that may be realized will not be available until December 2004.

Finding #12: Prisons cannot show that they consistently perform prospective and concurrent reviews when required.

Our review of invoices requiring prospective and concurrent reviews revealed that many of the prisons are unable to demonstrate that they complete the reviews. By not having the documentation of these reviews, prisons cannot show that they do not pay for unnecessary medical services.

We recommended that Corrections ensure that the Utilization Management (UM) nurses adhere to the UM guidelines requiring them to perform and retain documentation of their prospective and concurrent reviews.

We also recommended Corrections direct HCSD to establish a quality control process that includes a monthly review of a sample of prospective and concurrent reviews performed by the prisons.

Department Action: Partial corrective action taken.

Corrections stated that HCSD is implementing processes to integrate clinical appropriateness and administrative oversight into its UM program and expects full implementation in October 2004. Also, the UM program has begun a process to review and update its program guidelines and plans to present the revised guidelines to management in December 2004, including an implementation schedule for 2005. On the administrative side, the UM supervising nursing staff have initiated monitoring and compliance activities. Between October 2003 and May 2004, the UM program implemented a new data collection system. The data is collected at the prison level, appended to a statewide database, and used to generate a number of reports used by program management. The reports, as well as the raw data, allow the UM supervisors to monitor standardization and compliance. The UM staff are also actively exploring an alternate program structure for management of UM activities in the field, as well as other means to improve efficiency of services, and will work through the annual budget process if resource needs are identified.

Corrections stated that the HCCUP staff are in the process of contracting with a vendor to perform reviews of medical invoices and expects to have a contract in place by February 2005. In addition, the Budget Act of 2004 authorized HCSD to establish 24 additional positions for the HCCUP program. HCSD plans to fill these positions by January 2005. These additional positions will allow HCCUP to establish quality control processes, include reviewing a sample of invoices processed by the program's

field analysts. Corrections anticipates these processes will be in place by March 2005. In addition, as of August 2004, HCCUP established and is using 52 validation reports to ensure the accuracy of data entered by field analysts. Using the validation reports, HCCUP will begin performing monthly audits of a sample of invoices submitted by field analysts. These audits will begin by March 2005. Also, as HCCUP staff identify data entry errors from the standardized validation checks and development of reports, it will notify all analysts, on a flow basis, of the appropriate manner to enter the data. HCCUP staff will also provide a five-day training for new staff hired and any staff that do not receive the training scheduled between December 2004 and March 2005. Finally, HCCUP will establish a peer review program that includes identification of additional data integrity improvement needs. HCCUP staff will develop a training plan based upon peer review findings and the training will be delivered to staff during the annual statewide HCCUP meeting in May 2005.

Finding #13: With unclear guidelines, prisons inconsistently perform retrospective reviews.

Corrections has not provided prisons with clear guidance regarding changes to the retrospective review process resulting in confusion to the prisons and inconsistent performance of retrospective reviews.

We recommended that Corrections clarify and update the UM guidelines for performing retrospective reviews.

Department Action: Pending.

Corrections reported that HCSD continues to explore options for modifying its retrospective review process, including outsourcing to a private contractor, obtaining additional positions, redirection of duties to other clinical staff, or a proposal for reorganization of the current UM structure. HCSD continues to emphasize insufficient resources to perform 100 percent retrospective review, and reports that community standard is less than 100 percent review and varies as a function of automated systems designed to automatically flag provider targeted issues. Corrections reported that it lacks such a system but patterned the community standard by verbally directing review of 100 percent of noncontract providers and 10 percent intensive review, via random selection, on all contracted

facilities. HCSD is further analyzing the resources needed to increase its retrospective reviews, and may address this issue through a future budget process.

Finding #14: Failing to adequately monitor medical service invoices, prisons sometimes overpay providers, unnecessarily increasing the State's medical costs.

Prisons overpaid providers \$77,200, did not take discounts totaling roughly \$12,700, incurred late penalties of \$5,900, and could not provide evidence that inmates received medical services totaling \$69,200.

We recommended that Corrections direct HCSD to establish a quality control process that includes a monthly review of a sample of the invoices processed by the prisons' Health Care Cost and Utilization Program analysts.

We also recommended that Corrections ensure that prisons recover any overpayments that have been made to providers for medical service charges. Similarly, prisons should rectify any underpayments that have been made to providers.

Further, we recommended that Corrections evaluate its payment process to identify weaknesses that prevent it from complying with the California Prompt Payment Act.

Department Action: Pending.

Corrections reported that HCCUP and accounting staff met and discussed alternatives for identifying and recovering overpayments and underpayments. As previously stated, HCSD plans to contract with a vendor to review medical invoices. Also, accounting staff have begun to determine system or process changes necessary to allow Corrections to readily identify and provide reports on overpayments and underpayments. Corrections anticipates that it will be able to provide management and other staff with reports by January 2005.

Corrections stated that in August 2004, staff met to identify weaknesses that prevent it from complying with the California Prompt Payment Act. Due to the complexity of some issues, staff determined that a work group would be established to identify potential solutions. However, Corrections stated that its work group meetings were delayed because of unfilled positions and other priority assignments, including completion of year-end closing and the development and training associated with its 2004–05 contract monitoring database. Corrections anticipates regular monthly meetings to begin in November 2004 and implementation of procedures by the end of fiscal year 2004–05.