

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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REPORT NUMBER 2003-117, APRIL 2004

California Departments of General Services' and Corrections' responses as of May 2005

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to examine the process that the California Department of Corrections¹ (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*

¹ On July 1, 2005, the Youth and Adult Correctional Agency and the departments and boards (including the Department of Corrections) within the agency became the California Department of Corrections and Rehabilitation. However, for purposes of our report we use the former department name.

☑ *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.*

of Corrections: Utilizing Managed Care Practices Could Ensure More Cost-Effective and Standardized Health Care, issued in January 2000.

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.

General Services' Action: Corrective action taken.

General Services has eliminated its long-standing policy exemption and in January 2005 issued Management Memo Number 05-04 (Management Memo), 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.

Corrections' Action: Corrective action taken.

Corrections stated that it has amended its contract boilerplate language to include a requirement for the submittal of charge description masters (CDM). Corrections also reported that it met with the Office of Statewide Health Planning and Development and they developed procedures that will allow Corrections to obtain CDM annually, beginning in July 2005, for each hospital that 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.

Corrections' Action: Partial corrective action taken.

Corrections reported that it developed and implemented a new medical rate exemption form and 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.

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 in April 2005, it awarded a contract 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.

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.

Corrections' Action: Corrective action taken.

Corrections stated that its Health Contracts Services Unit (HCSU) in July 2004 initiated an ongoing process for contract renewal requests that requires staff to routinely analyze 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 review and approval, rather than the Office of Contract Services (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.

Corrections' Action: Partial corrective action taken.

Corrections reported that its HCSU staff, except newly hired staff, completed analytical skills, cost benefit analysis, and negotiation skills workshops. Further, as previously mentioned, HCSU has contracted for additional services from an expert in health care contract negotiations. Corrections reported that it anticipates that the contractor will provide training to HCSU staff beginning in September 2005. The training will include financial and technical expertise in contract rates, terms, and the negotiation process. Subsequent to HCSU staff training, Corrections will develop training plans for the field staff.

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.

Corrections' Action: Corrective action taken.

Corrections reported that HCSU staff are currently documenting and including in the files their efforts to obtain per diem rates for each of the hospital contracts. Also, HCSU staff negotiating contracts are requesting rates to be tied to a reimbursement benchmark, such as Medicare. In those cases where hospitals refuse, the HCSU staff are pursuing per diem for inpatient services, as well as maximum caps on all outpatient rates that are a percent of billed charges. Corrections reported that if a hospital refuses all of the Corrections' rate proposals, HCSU staff are not entering into the contracts.

Finding #7: HCSD and prisons have not submitted many medical service contracts to Corrections' 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.

Corrections' Action: Partial corrective action taken.



Corrections stated that it formed a task force in October 2004 to reassess its policy memo and the feasibility of requiring staff to submit corrective action plans. However, Corrections informed us that it had to redirect its focus to address recent legislation requiring it to merge with all departments under the Youth and Adult Correctional Agency to create the California Department of Corrections and Rehabilitation. Corrections stated that the newly created department will continue to issue semi-annual report cards, however, until reports are available on the new divisions and programs, it believes requiring corrective action plans would be premature. Finally, Corrections stated that it has and will continue to place emphasis on reducing late contracts and amendments as well as ensuring fiscal accountability.

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.

Corrections' Action: Corrective action taken.

Corrections reported that it has corrected the errors we identified and has modified its procedures. Corrections also stated that it has and continues to provide training to its staff and managers on the need to attach a report that identifies NTPs associated with each master contract and the residual amount when submitting contract requests for review and approval. Finally, Corrections stated that it conducts random audits to ensure compliance with its master contract 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.

Corrections' Action: Corrective action taken.

Corrections reported that contract services 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, contract services 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.

Corrections' Action: Corrective action taken.

Corrections stated that contract services 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. Contract services 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.

Corrections' Action: Partial corrective action taken.

Corrections reported that it has a process in place to regularly analyze and discuss the usage of registry contracts with the health care managers through the monthly budget review process with fiscal management. Effective July 2004 the health care regional administrators and managers receive a copy of the vacancies versus registry report each month. In December 2004, HCSD's Fiscal Management Unit developed a new reporting form for institutions to complete and submit with their monthly budget plans. The reporting form allows the health care managers to analyze registry usage and vacancies from a global perspective.

Corrections also reported that as part of the HCSD's strategic plan, it has established workgroups that will review data on patterns of registry utilization. Corrections reported that it plans to establish focus improvement teams to monitor processes and expects to have quantifiable data regarding outcomes beginning December 2005.

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.

Corrections' Action: Corrective action taken.

Corrections reported several changes to improve its UM program. Specifically, Corrections stated that its UM program staff have implemented efforts to ensure that field UM nurses adhere to the UM guidelines requiring staff to perform and retain documentation of their prospective and concurrent reviews. UM headquarters staff distributed and trained all UM nurses, health care managers, and chief medical officers on changes to the UM guidelines and its UM database in February and March 2005. Changes in the guidelines included new focus areas for review. These focus areas were established based on consultant reports indicating high cost and high volume services that may have been avoidable. Training also covered Corrections' level of care criteria (Interqual) that it will use to standardize review of all acute care community admissions.

Corrections stated that this will help identify and improve areas of unavoidable community inpatient stays. Changes to its UM database will enable executive staff to view management reports related to utilization of inpatient and outpatient resources.

Corrections stated that it restructured the UM program to include additional supervising registered nurses, which will enable increased oversight, training, and monitoring of all UM program policies and procedures. UM nursing supervisors continue to monitor compliance activities, using a standardized supervisory review tool when they perform UM site visits. This tool will enable UM supervisors to identify the status of the UM program at each institution and provide further direction for improvement. Corrections also stated that the restructuring includes the establishment of additional registered nurse staff to work out of preferred provider hospitals (those with medical guarding units). These nurses will perform daily concurrent reviews using Interqual level of criteria. This will enable Corrections to monitor and decrease the number of unavoidable community hospital stays. In addition, these registered nurses will plan and assist with the discharge of inmate patients back to an institution in a timely manner.

Finally, Corrections stated that it has begun collecting UM data to produce reports that will identify trends for management review and quality improvement.

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.

Corrections' Action: Partial corrective action taken.

Corrections stated that it has finalized specific guidelines and provided training to UM nurses, health care managers, and chief medical officers for retrospective review of unscheduled community emergency room transfers and unscheduled admissions. Corrections stated that it selected specific focus areas based on previous areas of high cost and high volume. A team of physicians at each institution will evaluate these focus areas during the Medical Authorization Review subcommittee meetings, which are to be held on a weekly basis. The subcommittee shall determine after review and discussion which of the following four categories the transfer best describes: necessary and unavoidable, necessary and potentially avoidable, unnecessary due to internal capability, or unnecessary due to criteria not met. The collection of this data and other data will provide an opportunity for planning training needs, developing new protocols, and enhancing the quality and value of care.

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.

Corrections' Action: Partial corrective action taken.

Corrections stated that its Health Care Cost and Utilization Program established a quality control process that includes reviewing a sample of invoices processed by the program's field analysts. The quality control process also contains a peer review focus improvement team to further enhance its ability to identify overpayments/underpayments. Corrections reported that it identified and recovered \$9,513 in overpayments as of March 1, 2005. Additionally, Corrections reported that it is reviewing other potential net overpayments/underpayments totaling \$96,906 for accuracy and validity and upon validation, Corrections plans to collect or reimburse vendors as appropriate.

Corrections reported that its Health Care Cost and Utilization Program staff and accounting staff have established a process to identify late payment penalties by institution and contractor. Corrections also reported that it has established a cross organizational team to resolve issues identified. Finally, Corrections reported that its Health Care Cost and Utilization Program staff identified the need to capture more detailed penalty payment information and are in the process of developing those enhancements. It anticipates that the enhancements will be included in the fiscal year 2005–06 contracts monitoring database.