

## Insurers, Hospitals Face Audits for Health Care Reform Act Surcharges



**In his Health Law column, Francis J. Serbaroli takes another look at the troubles faced by insurers, hospitals and other health care providers when they are subjected to audits of their payments of surcharges required under New York’s Health Care Reform Act of 1996. He reviews the history of this law, the services covered and how the surcharges are calculated, and the problems that arise when these audits take place, and offers advice on how to deal with issues raised in the course of these audits.**

**By Francis J. Serbaroli | [January 21, 2021](#) | New York Law Journal**

In its continuing efforts to maximize revenue collection, New York state continues to aggressively audit insurers to determine if they have accurately paid statutory surcharges on bills for medical services provided to patients by licensed facilities such as hospitals, clinics, ambulatory surgery centers, and other providers. These surcharges were mandated by the Health Care Reform Act of 1996 (HCRA) (Ch. 639 Laws of 1996), and they apply not just to traditional health insurers and managed care plans, but to all insurers that provide coverage for medical services provided in health care facilities. These include property and casualty insurers, Workers’ Compensation carriers, automobile no-fault insurers, and others. They also apply to hospitals and other licensed facilities. We offer here a primer on the HCRA surcharges, how these audits are being carried out, and pitfalls to avoid.

## **History**

From 1983 to 1997, the state of New York strictly regulated inpatient hospital reimbursement rates under what was known as New York's Prospective Hospital Reimbursement Methodology (NYPHRM). Under NYPHRM, the state subsidized losses incurred by hospitals that were attributable to uncompensated care, known as Bad Debt and Charity Care (BDCC), for those hospitals that had higher rates of charity services. The program also subsidized approximately 40% of the costs of graduate medical education (GME) residency programs in New York. NYPHRM financed both BDCC and GME by setting fixed rates that hospitals could charge for in-patient procedures. There was no competitive rate negotiation.

In 1997, NYPHRM was abolished in favor of the Health Care Reform Act, or HCRA. HCRA deregulated the hospital reimbursement system, allowing rates to be negotiated between hospitals and payors. However, in order to continue funding BDCC and GME, HCRA imposed a surcharge on most in-patient hospital procedures, as well as medical services provided in licensed clinics and other facilities.

## **Payments**

Payors, such as insurance carriers, managed care plans and third-party administrators (TPAs) of employer self-insurance plans have a choice as to how they remit these surcharges. They may choose to pay the surcharges directly to the hospital or other provider. Alternatively, payors may elect to pay the surcharges directly to an HCRA pool administrator designated by the Department of Health (DOH).

Payors (including self-insured entities) that choose to remit payments to the provider, instead of directly to the pool, must pay a surcharge of 9.63% on the cost of patient services to fund BDCC. They must also pay a surcharge to fund GME, the percentage of which varies by region based on the number of GME programs that each region supports. Finally, payors who do not elect to remit their surcharges directly to the pool administrator must pay an additional 28.27% on each provider claim. The provider must then remit these surcharges to the DOH-designated pool administrator, but the provider is allowed to keep 2% of the 28.27% hospital claim surcharge.

If payors elect to pay the pool directly, the 28.27% per claim hospital surcharge is waived. Moreover, the basis of the calculation for the GME surcharge converts to a Covered Lives Assessment (CLA), based on the number of non-Medicare eligible covered persons or families residing in a particular region, as well as the number and size of teaching hospitals in that region. These payments are made per member, per month. Electing payors are subject to DOH's reporting and auditing requirements to verify that the HCRA surcharges have been fully paid.

## **Surcharged Services**

Complicating things further, some medical services are surchargeable, while others are excluded from the surcharge. Surchargeable services include both inpatient and outpatient hospital services, emergency services, ambulatory surgery, and other health-

related services. Excluded from surcharges are payments for services provided in residential health care facilities, adult day care services, hospice and home care services, and physician or faculty practice services. Any services provided to patients covered by the Medicare program are also exempt from surcharges.

Services provided by diagnostic and treatment centers and ambulatory surgery centers are generally surchargeable. Exceptions include services to Medicare beneficiaries, services to HMO members but only if the HMO operates the center, and all private physician services that are separately billed.

Laboratory services are surchargeable for inpatient and emergency room admissions (including pre-admission laboratory testing), as well as scheduled outpatient clinic services when ordered either by hospital employees or contracted providers who are providing direct patient care at the hospital or diagnostic and treatment center. Excluded from HCRA surcharges are laboratory services to Medicare beneficiaries, services to HMO members (if the HMO operates the laboratory), and laboratory tests performed on samples drawn or collected outside of New York state.

## **Audits**

Those payors who elect to remit HCRA surcharges directly to DOH's HCRA pool administrator (thereby waiving the additional 28.27% surcharge) must submit to the DOH's auditing requirements. The DOH's objective in mandating HCRA compliance audits is to determine whether payors have reliable information technology systems, processes and controls in place to ensure the accurate calculation and payment of HCRA surcharges. If they do not, DOH will assess any underpayments so that they can be corrected.

The audits usually, but not always, cover a six-year period. DOH does not conduct these audits itself, but contracts with outside auditing firms, such as KPMG, to perform payor as well as provider compliance audits.

The protocol for assessing whether HCRA surcharges have accurately been applied and paid begins with a review by the auditing firm of the payor's processes and procedures for determining its direct surcharge obligations. Each audited payor is required to complete a questionnaire—created by the auditing firm and approved by DOH—describing the payor's internal process for determining its surcharge obligations.

After receiving the completed questionnaire, the auditing firm reviews the responses for accuracy by examining all data and documentation provided by the payor for the year under review. If the data and documentation provided cannot be used for compliance audit testing, the auditing firm must notify DOH. In addition, the auditing firm must then describe to DOH the alternate procedure it plans to use to verify the accuracy of the payor's surcharge payments, as well as quantify any underpayments of surcharges.

The auditing firm conducts interviews with payor personnel at various levels within the organization for the purpose of reviewing the policies and procedures that the payor has in place for completing monthly surcharge reports for the applicable audit period. The

auditing firm examines these policies and procedures to determine how the payor processes claims, applies the surcharges, and remits them to the HCRA pool. Additionally, the auditing firm reviews the manner in which the payor identified non-claims based payments (such as CLA payments), and payments made pursuant to advance payment, capitation and/or financial risk-sharing arrangements for surcharge payment purposes.

### **Checking Accuracy**

The payor must also provide the auditing firm with its certified financial statements for the year under review. The auditing firm then reconciles the certified financial statements (or those from the previous year, if the statements from the current year are unavailable) with the payor's books and records. These books and records must tie out to the payor's HCRA reports in order to be deemed reliable by the auditors.

The auditing firm then performs a test of the payment data that is reflective of the total mix of surchargeable services, and inclusive enough to draw a valid conclusion. This test is intended to identify services for which the payor did not collect surcharges, or did not collect them at the proper rate. For services where a surcharge was appropriate but not applied, the payor is asked to explain the error, as well as to disclose all underpayments. Similarly, in instances where a surcharge was not applied, the payor is asked to provide proof that the claim was not surchargeable—sometimes in a format that the payor did not foresee prior to audit. Based upon the payor's explanation, the auditing firm then calculates any necessary adjustments, starting from the presumption that all hospital claims, or diagnostic and treatment center claims, are surchargeable.

If, for some reason, calculation of the actual surcharge underpayment is not possible, the auditing firm identifies the totality of services that were not surcharged at the full rate. Then, using a statistical sampling, the auditing firm finds the number of sample errors and extrapolates these errors to the total group of services, identifying the low, mean and high point in surcharge underpayments. In the ordinary course, the payor is allowed one opportunity to comment upon the auditor's findings and provide additional information.

### **Interest/Penalties**

Any actual underpayment of HCRA surcharges is just the beginning of the problem. If an audit determines that a payor has paid less than 90% of what the DOH estimates should have been paid in any given month, the payor must pay interest on the difference. Interest is calculated at the federal short-term rate plus 3%, or 12%, whichever is greater. If the audit determines that the payor has paid less than 70% of what DOH estimates should have been paid in any given month, the payor must pay an additional penalty of 5% on the difference for each month overdue, capping at 25%. Because audits invariably occur more than five months after the payment was made, penalties (when applicable) are virtually always capped at 25%. Given that audits generally cover a six-year period, sizable underpayments can result in the assessment of significant interest and penalties, even up to doubling the total underpayment.

Payors can face problems in defending themselves during the course of an HCRA surcharge audit due to a number of factors, including a lack of familiarity with the HCRA statutes and the audit process, poor communication with outside auditors, and record-keeping issues (lack of historical source data). Moreover, outside auditors have made significant errors in applying HCRA surcharges to services that are not surchargeable, such as separately billed private physician services.

These audits are also taking place under relatively tight timeframes, thereby putting strains on the internal resources that a payor must devote to retrieving and gathering data, running reports, and responding to auditor demands. DOH has little or no tolerance for extensions of time, and any extensions granted at a particular phase of an audit may result in an acceleration of the audit's later stages to make up time and keep the audit on schedule.

### **Avoiding Pitfalls**

Payors facing these audits have repeatedly expressed frustration over the fact that they didn't understand what was happening during their audit until it was too late and they faced a huge liability. Sometimes this problem is due more to the failure to interpret auditor communications than to a failure to comply with HCRA statutes. To put it another way, it's often not that the payor or provider did anything wrong, but that it didn't clearly prove to the outside auditor that it had done everything right.

Most HCRA audits are taking place at health insurers, managed care plans, auto insurers, and other payors of medical benefit claims. As noted earlier, DOH is also auditing hospitals to verify whether they properly billed, collected and paid over HCRA surcharges on services to patients covered by payors that elected not to remit HCRA surcharges, but to pay them to the provider.

How can an organization avoid the pitfalls of an HCRA audit? Here are some steps to consider, whether or not the organization is currently being audited:

**Understand the Rules.** It is important to understand how HCRA works and what medical services are or are not subject to surcharge. Consulting with experienced counsel can help entities find weaknesses in their claims payment and IT infrastructures before the auditors do, thereby allowing them to remedy underpayments earlier, and lessening the associated interest and penalties.

**Keep Accurate Records.** As noted above, much of an audit involves providing proof in a format acceptable to DOH of what has and has not been paid.

**Develop and Document HCRA Policies and Procedures.** Many payors and hospitals had their HCRA policies, procedures and IT codes developed years ago by staff who are no longer working for them. As a result, during an audit, they may not be able to explain to the auditors why certain claims were or were not surcharged. Thus, the payor or hospital should develop accurate HCRA policies and procedures, adequately document them, keep them readily accessible, and make them part of the training for new staff.

**Perform Regular Self-Audits.** Appointing staff or engaging an outside auditor or consultant to perform self-audits of HCRA processes can be an important step in identifying and remedying potential problems.

**Don't Wait To Seek Counsel.** If faced with an audit, seek immediate help. Certain HCRA auditors, for instance, are under the erroneous impression that all hospital bills are surchargeable. Experienced HCRA counsel can guide a payor or hospital through the very real complexities of the audit process, and assist them in obtaining a more accurate audit result.

HCRA surcharges are here to stay for the foreseeable future, and so unfortunately are widespread HCRA surcharge audits. In this context, as the old saying goes: “An ounce of prevention is worth a pound of cure.”

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