



# **STATE OF NORTH CAROLINA**

**DEPARTMENT OF PUBLIC SAFETY  
DIVISION OF ADULT CORRECTION  
RECOVERY AUDIT EFFORTS  
FINANCIAL RELATED AUDIT**

**FEBRUARY 2013**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**DEPARTMENT OF PUBLIC SAFETY  
DIVISION OF ADULT CORRECTION  
RECOVERY AUDIT EFFORTS**

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**Beth A. Wood, CPA**  
State Auditor

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**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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February 27, 2013

The Honorable Pat McCrory, Governor  
Members of the North Carolina General Assembly  
Kieran Shanahan, Secretary, Department of Public Safety

This report presents the results of our financial related audit at the Department of Public Safety, Division of Adult Correction (Division). Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The objective of our audit was to determine if the Division could use focused recovery audit efforts to identify overpayments in outside inmate medical care.

We found that the Division can benefit from focused recovery audit efforts to identify overpayments.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

## TABLE OF CONTENTS

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	PAGE
BACKGROUND AND GENERAL OBJECTIVE .....	2
SCOPE AND SPECIFIC OBJECTIVE .....	3
METHODOLOGY .....	4
RESULT AND CONCLUSION .....	5
AUDIT FINDING AND RESPONSE.....	6
APPENDIX .....	9
ORDERING INFORMATION .....	10

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## **BACKGROUND AND GENERAL OBJECTIVE**

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### **BACKGROUND**

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Department of Public Safety, Division of Adult Correction.

This audit is a follow-up to the financial related audit of the Department of Public Safety, Division of Adult Correction issued in May 2012. In that audit, auditors recommended that the Division of Adult Correction expand its recovery efforts of medical service payments and consider contracting with a professional recovery audit firm to enhance its recovery efforts.

### **GENERAL OBJECTIVE**

The general objective of this financial related audit was to identify improvements needed in the internal control over fiscal matters. The specific fiscal matters included in the audit are described in the Scope and Specific Objective section of this report.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

## **SCOPE AND SPECIFIC OBJECTIVE**

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Our audit scope covered the period from July 1, 2011, to June 30, 2012, and included selected internal controls in the Medical Claims Management Section at the Division of Adult Correction (Division). Our audit focused on internal controls related to identification and recovery of overpayments made to hospitals that provided inmate medical care. The specific objective of our audit was to determine if the Division could use focused recovery audit efforts to identify overbillings for hospital inmate medical care.

## METHODOLOGY

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To accomplish our audit objective, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objectives. Specifically, we interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances. We also hired a vendor that specializes in medical recovery audits to review 10 medical claims for possible overbilling. We applied a judgmental approach to our sample of medical claims. As a result, we were unable to project our results to the population.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment; (2) risk assessment; (3) control activities; (4) information and communication; and (5) monitoring.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective.



## **RESULT AND CONCLUSION**

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We determined that the Division can benefit from focused recovery audit efforts to identify overpayments in inmate medical care. These items are described in the Audit Finding and Response section of this report. Management's response is presented after the finding. We did not audit the response, and accordingly, we express no opinion on it.

## AUDIT FINDING AND RESPONSE

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### **Division Can Benefit from Focused Recovery Audit Efforts**

The Department of Public Safety's Division of Adult Correction (Division) can reduce its inmate medical costs by performing focused recovery audits of hospital medical claims. An auditor-initiated review of 10 of the largest hospital claims<sup>1</sup> identified about \$105,700 in overpayments made to eight hospitals during the past fiscal year (see appendix). The amount paid for the 10 claims totaled about \$1 million, representing an overpayment of 10.6 percent. The Division did not previously identify these or any other overbillings because it does not perform externally focused recovery audits of hospital charges.

### **Overpayments Identified**

Auditors contracted with a vendor that specializes in recovery audits of medical claims to review 10 of the largest hospital claims submitted to the Division during the fiscal year ending June 30, 2012. The contractor used its analytic software and physician reviewers to assess selected claims, the underlying itemized billing detail, and associated medical records. Medical records for each episode of care were reviewed by a licensed and board-certified physician.

The contractor's review found approximately \$105,700 in overpayments within the 10 claims. Overpayments occurred because of separate billings that are normally part of a larger service,<sup>2</sup> charges for services provided with no clear patient benefit, and duplicate charges.

Not realizing nor suspecting the claims included excessive billing, the Division paid the hospitals based on the bills received.

The overpaid amount for each of the 10 claims varied considerably. Five claims had no overpayments while four other claims had overpayments of more than \$20,000 each (see appendix).

In early January of 2013, the contractor contacted and presented its analysis to each hospital. Hospitals were given the opportunity to respond to the questioned charges and the contractor adjusted their challenges where appropriate. One hospital has not yet responded to the charges challenged by the contractor.

Since this audit was limited to 10 of the largest claims (about \$1 million), the results cannot be projected to the total population of 893 hospital claims (about \$14 million) the Division reported it paid during the fiscal year.

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<sup>1</sup> Auditors targeted some of the largest claims because they offer more potential for a higher overpayment. The Division paid approximately \$5 million for the top 100 episodes of outside hospital care.

<sup>2</sup> Examples of items that are part of a larger service include charging for drawing blood and a lab test or charges for oxygen for a patient in surgery or on a ventilator.

## AUDIT FINDING AND RESPONSE

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### **Division Should Look for Overpayments**

By law, the Division is required to explore medical cost containment methods.<sup>3</sup> Medical recovery auditing is a widely used cost containment practice used to identify and recover improper payments made due to errors such as:

- Administrative non-compliance (non-covered items, duplicate payments, ineligible recipients, etc.);
- Intentional (fraudulent) and unintentional billing errors; and
- Inappropriate or unnecessary services.

Large payers of medical claims, such as health insurance companies and Medicare, commonly use externally focused recovery audits (hospital bill audits) to detect and recover overpayments of medical claims.

As noted in a previous audit by the State Auditor,<sup>4</sup> the Division could not identify these overpayments because its existing recovery audit efforts do not include audits of hospital bills for the legitimacy of the claims.

### **Recommendation:**

The Division should use the results of this audit to pursue and recover the overpayments identified.

The Division should contract with a professional recovery audit firm to enhance its existing recovery audit effort. The Division should focus its recovery audit efforts on larger claims to maximize the cost benefit of its recoveries. The Division should pursue and recover overpayments identified.

### **Agency Response:**

The Department is in agreement that the Division of Adult Correction (DAC) can benefit from a system that will eliminate overpayments and provides a mechanism for auditing payments on large claims.

Currently, it has not been determined the extent to which overpayments occur. The Department agrees that recovery of overpaid claims is important, and therefore is focused on contracting out the claims management process to a contractor who has a system designed to prevent overpayments from occurring.

A Request for Information (RFI) was sent to potential vendors who are experts in claims management processing. The results from that RFI are due back by March 6, 2013. The Department will interview several firms to obtain information on how to implement a

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<sup>3</sup> *Session Law 2010-31 section 19.6.(e)*

<sup>4</sup> *Division of Adult Correction, May 2012*

## **AUDIT FINDING AND RESPONSE**

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third party claims management processing firm, and how the firm's system can most efficiently and effectively be audited for recovery of overpayments.

Obtaining that information will guide the Department in choosing the best method of audit recovery. The Department plans to use audit recovery techniques to audit claims.

## APPENDIX

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The table below shows the claims reviewed by the contractor. The claims were selected using a non-statistical sample, so analysis is limited to the sample items only and should not be used to make any broader conclusions about the hospitals or other episodes of care. Auditors and their contractor did not audit the quality of care provided by these hospitals and express no opinion of the care provided.

<b>Claim</b>		<b>Billed</b>	<b>Paid</b>	<b>Overpaid</b>
1	HOSPITAL A*	\$ 162,986.50	\$ 76,603.66	\$ 22,230.71
2	HOSPITAL B	\$ 68,441.70	\$ 27,376.68	\$ 0.00
3	HOSPITAL C	\$ 301,869.25	\$ 211,308.48	\$ 22,786.47
4	HOSPITAL D	\$ 295,738.01	\$ 207,016.61	\$ 34,799.25
5	HOSPITAL E	\$ 102,765.37	\$ 92,488.83	\$ 0.00
6	HOSPITAL F	\$ 204,924.60	\$ 130,266.85	\$ 0.00
7	HOSPITAL G	\$ 188,089.07	\$ 53,825.59	\$ 0.00
8	HOSPITAL D	\$ 149,306.31	\$ 104,514.42	\$ 24,322.69
9	HOSPITAL C	\$ 135,406.16	\$ 94,784.31	\$ 1,535.36
10	HOSPITAL H	\$ 118,911.83	\$ 36,351.64	\$ 0.00
		<u>\$1,728,438.80</u>	<u>\$1,034,537.07</u>	<u>\$ 105,674.48</u>

\* Hospital has not responded to potential overpayments as of February 25, 2013.

## **ORDERING INFORMATION**

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://www.ncauditor.net). Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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This audit required 585 audit hours at an approximate cost of \$48,969. The cost represents 0.35% of the approximately \$14 million in total expenditures subjected to audit.