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Claims under the microscope: Hospitals add observation units to reduce inpatient stays; costs fall, but scrutiny rises

By Jay Greene

The growth of hospital observation units — short patient stays of 48 hours or less — in Southeast Michigan has been stimulated the last three years by Medicare and private payer denials of claims for inpatient admissions.

Legal and hospital experts say these denials can lead to revenue losses, payment delays and, in some cases, higher bills for patients that can run into the thousands of dollars for a typical three-day stay.

A recent article by *Modern Healthcare*, a sibling publication of *Crain's Detroit Business*, said observation bed use increased by 40 percent from 2007-2011. Factors in addition to insurer scrutiny include a need to free up inpatient beds, reduce costs and increase patient flow.

On top of Medicare and private payer audits, Medicare last year announced it would more carefully scrutinize inpatient and observation unit claims before reimbursement is made at hospitals in 11 states, including Michigan.

Millions of dollars in denied charges and thousands of dollars in appeal costs are at stake for hospitals in Michigan when Medicare and private payers deny what they consider as inappropriate claims, said Abby Pendleton, partner with Southfield-based **The Health Law Partners PC**.

Hospitals are doing a better job at identifying patients as inpatient or observation and creating short-stay units to house the patients, Pendleton said.

"The problem still is admitting physicians still need to document the decisions they make (for both inpatient and observation stays). It is difficult to round all the doctors up to get them to document what they need in charts," she said.

The **Michigan Department of Community Health** has also appointed a work group to study hospital reimbursement issues, including observation stays of Medicaid patients. Hospital, insurance and state officials are in the work group.

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Earl Doucet, administrative director of emergency services at Henry Ford Macomb Hospital, says patients are better served by waiting in observation units rather than the emergency room.

What is an observation patient?

An observation patient is one who meets the following criteria:

- Stabilization and discharge are expected within 24 hours.
- More than six hours of treatment will be required.
- Clinical diagnosis is unclear and may be determined in less than 24 hours.
- A procedure is underway that requires more than six hours of medical observation.
- Complications are present from ambulatory surgery or medical procedures.
- Symptoms are unchanged at least four hours after treatment in the emergency department.

Source: McKesson Corp.'s InterQual and Milliman Care Guidelines

Like most hospital systems, **Beaumont Health System** has been rapidly adding observation units and beds at its three

hospitals in Royal Oak, Troy and Grosse Pointe to comply with Medicare and private payer standards for admissions, said Nick Vitale, Beaumont's CFO.

"The reason observation is becoming such a hot issue is the government and other payers are looking to reduce the cost of health care," Vitale said. "Typically a hospital gets paid 10 times more for inpatient stay than observation stay."

Costs are much lower for observation patients because they mostly don't require the same staffing or technology. Most observation unit room sizes are about 100 square feet with no bathroom as opposed to a typical non-obstetric private hospital room of 200 to 300 square feet.

Vitale says Medicare and private payers use nationally published guidelines — typically InterQual or Milliman — for determining whether a patient should be classified as an inpatient admission or observation status. *(See box above.)*

A complicated choice

Helen Stojic, director of corporate affairs at **Blue Cross Blue Shield of Michigan**, said the state's largest health insurer stopped auditing inpatient admission validity a few years ago. She said Blue Cross doesn't have data to show payment denial trends.

"We ask attending physicians to make the decision to admit based on national screening guidelines, industry practice and the patient's health," Stojic said. "(Blue Cross) does not perform retrospective reviews/audits of short-stay inpatient admissions for our commercial members. We discontinued reviews of traditional and PPO admissions for site of care several years ago."

For short stays up to 48 hours, Blue Cross pays an hourly rate, Stojic said.

While two other commercial payers **— Health Alliance Plan** and **Priority Health** — contacted by *Crain's* did not respond to questions about inpatient claim denials before deadline, hospital executives said private payers also have followed Medicare's lead.

"We have seen an increase in inpatient claim denials based on 'medical necessity criteria' from all commercial payers," Vitale said.

"Inpatient versus outpatient status is under increasing scrutiny," Vitale said. "We are challenged with ensuring that our patients receive the best care in the most appropriate setting. We are also challenged by the increasing administrative burden of public and commercial plans having multiple, complex and diverse programs in place related to inpatient admissions."

Pendleton said Medicare released new inpatient payment guidelines last month that she believes will increase the difficulty for hospitals in classifying a patient as an admission.

For example, inpatient stays expected to "last less than two midnights are generally inappropriate for inpatient hospital admission and Part A (hospital) payment absent rare and unusual circumstances," according to Medicare's Aug. 2 final rule.

Vitale said Beaumont physicians put extra effort into documenting a clear medical reason for an inpatient admission or for patients who are designated for observation.

"We have been placing more patients in observation status because it is providing the right care at the right level. It also creates inpatient capacity for us" when patients are in observation units instead of in medical or specialty unit floors, Vitale said.

From 2010 to 2012, **Beaumont Hospital** in Royal Oak doubled the number of patients classified as observation to 14,500 from 7,400, said Leslie Rocher, M.D., the hospital's physician in chief and senior vice president of the health system.

Beaumont Hospital has two observation units that total 45 beds. Beaumont recently announced plans to build a new emergency department, which will include a larger observation unit.

"From the physician end, it is confusing," Rocher said of the inpatient admission rules. "The doctor knows the patient is sick and needs to be admitted for a day or two. It becomes a bureaucratic decision. The payers look at it and pay you at the observation rate. We try to do the right thing for patients."

But Rocher said in the instance when Medicare or private payers deny the inpatient stay and when hospitals rebill as an outpatient stay, Medicare and some private payer rules require that hospitals collect deductibles and copayment amounts from patients.

Under Medicare, hospitals would then be required to refund patients for inpatient copays and deductibles, although those refunds could happen years after the admission, depending on the timing of the denials, Pendleton said.

A Catch-22

Not only are physicians sometimes perplexed by admission rules, Medicare appears to want it both ways — fewer admissions and fewer observation stays, said Jessica Gustafson, a partner with Health Law Partners.

First, Medicare began auditing and penalizing hospitals for inappropriate inpatient stays to reduce costs. But when hospitals moved more patients into observation status to avoid the inpatient denials, Medicare began denying those claims, Gustafson said.

In 2010, Medicare sent a letter to the **American Hospital Association** that criticized hospitals for large increases in observational claims, Gustafson said.

"Hospitals can't win," said Pendleton. "Hospitals are trying to shift Medicare patients to observation status to lower costs, but in some instances it costs patients more money" out of pocket.

Over the past several years, the **Centers for Medicare and Medicaid Services** have hired third-party auditors to hunt down improper Medicare payments and unearth potential fraud, waste and abuse. These so-called Recovery Audit Contractors are paid a financial bounty of up to 12.4 percent for successfully challenging claims.

Like most hospitals, Vitale said, Beaumont generally appeals claims denials — and wins.

"Beaumont has been very successful in defending (payment denials). We don't have that many," Vitale said. "We have done a good job in documenting our decisions and locating patients in the appropriate areas."

Observation as a tool

Over the past 10 years, **Henry Ford Health System** has been working to reduce inpatient length of stay by improving care coordination within the hospital, said Bob Riney, the health system's president and COO.

"Things that once required six or seven nights are now done outpatient," said Riney, adding that the use of observation beds is another tool to reduce length of stays.

In 2009, **Henry Ford Macomb Hospital** in Clinton Township converted part of its emergency department to a 20-bed dedicated observation unit to complement the ER and demand for short-stay patients, said Earl Doucet, administrative director of emergency services.

"Most patients (more than 96 percent) come to the observation unit from the ER," Doucet said. "Very rarely do they come from a physician office or back from inpatient units."

As many as 20 percent of patients are flipped from observational status to inpatient units because they have been found to have a more serious medical problem.

"Instead of having patients stuck in the ER, waiting for test results, it is better they come into the observation unit," Doucet said.

With a daily occupancy rate of 90-100 percent, Macomb Hospital is considering expanding the number of observation beds, Doucet said. Average length of stay has increased slightly the past 18 months to 1.04 days from 0.896 days, he said.

"Last year we had a 15 percent increase in ER visits because of population growth in the area and more older patients coming in with symptoms of stroke and heart attack," said Doucet, adding that Macomb Hospital recently was also designated a level-two trauma center that added more patients.

Riney said patient admission denials have caused Henry Ford physicians to change their criteria.

"If there is a judgment call, you start them out as observational case," Riney said. "Consumers are also interested in being in the hospital the least amount of time."

Once physicians get the test results back, Riney said, patients are either sent home, or if a serious problem is found, admitted.

But Riney said sometimes hospitals and payers disagree.

"Insurance companies identify inappropriate admissions and have rejected those admissions," he said. "The hospital has to appeal. There is lost revenue, which is why we have expanded our observational settings."

Riney said all five of his system's hospitals, including **Henry Ford Hospital**, now have observation units.

"We believe we have enough observation beds now. We have the ability to flex up and down on other units depending on our needs," Riney said.

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