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## the abuse and misuse of observation services

As the Medicare program continues with its focus on improving the quality of care while reducing its cost, the financial impact on beneficiaries should remain a primary concern.

Improving the quality of hospital care provided to beneficiaries has been a strong area of emphasis for Centers for Medicare & Medicaid Services (CMS) in recent years. The agency's Hospital Value-Based Purchasing Program, for example, penalizes hospital payment based on substandard performance as measured by quality indicators.

Yet CMS also has persisted in supporting a policy that can have onerous effect on beneficiaries. Specifically, the agency's current misuse of observation status stands in sharp contrast to its dissemination of quality programs focused on improving clinical care.

### **An Unclear Policy**

Observation status is an outpatient service in which a patient is monitored prior to being admitted to the hospital to ensure that the inpatient services are required. Under current practice, however, it has become an administrative netherworld between outpatient and inpatient services.

There are neither statutes nor regulations that define *observation services*. In fact, some experts interpret Medicare statutes to specifically define certain observation services as inpatient services, as defined under Social Security Law (Sec. 1861 [42 U.S.C. 1395x]). Such services include room and board and nursing, diagnostic, and therapeutic services.

Observation status probably was conceived of originally as placing a patient into a separate holding area for evaluation and care while it was being determined whether admission was needed. Today, however, patients under observation status tend to be placed in a hospital bed among inpatients and are provided nursing services and diagnostic or therapeutic services in an inpatient setting.

### **Policy Consequences**

If a patient under observation status is subsequently admitted, there are no significant consequences to doing so: Care continues, and the patient will be billed as an inpatient. There is no separate charge or payment for the observation services rendered.

If a patient in observation status is not admitted, however, the consequences are significant. The hospital will be paid for an outpatient encounter instead of for an inpatient stay, even though the hospital incurs inpatient costs. Because such patients are billed as outpatients, they will be covered under Medicare Part B rather than Part A, meaning they will be paid under the outpatient prospective payment systems (OPPS) rather than under the inpatient PPS. The difference in payment from Medicare under these payment systems for some services can exceed \$10,000.

Depending on a patient's coverage, this difference can result in a significant liability for the beneficiary. Under the current approach, patients can be in hospital rooms for several days assuming they are inpatients, only to abruptly learn they have only been receiving observation services and that they now owe thousands of dollars for Part B services, which are not covered. A patient also may be stunned to learn that, despite the time in a hospital, he or she does not qualify for admission

to a skilled nursing facility (SNF), which requires at least three days of inpatient service beforehand.

This is an unconscionable way to treat a Medicare beneficiary. CMS recently began requiring hospitals to give a notice to each patient in observation status that explains the possible financial outcomes in advance. Providing such a notice does not fix the problem, however. It merely changes the time when the patient is told. Advance notice can be helpful if it occurs before discharge, because the patient then might still have an opportunity to involve his or her physician in obtaining inpatient admission, but it does not add to either the quality or the value of the care provided.

### **Policy Change Needed**

The policy of masquerading inpatient services as observation services needs to be changed. It is confusing and detrimental to Medicare beneficiaries and harmful to hospitals. Observation services can be useful, but they should be restricted to their primary purpose and for a short period of time. Today, they are being misused to the extent that some procedures are actually scheduled and performed on an outpatient basis rather than on a short-stay, inpatient basis.

CMS should make the restructuring of observation status a priority to bring an end to the deleterious effects on beneficiaries and prevent further inappropriate utilization of hospital services. With a more coherent and purposeful policy in place, the next step could even be to adopt a quality measure within the VBP Program to ensure compliance. ■

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