



April 28, 2011

Office of Audit Services
Jacob Javits Federal Building
26 Federal Plaza, Room 3900
New York, NY 10278

Report Number: A-02-09-01026

Mr. Peter S. Moore
Vice President, Medicare Division
Group Health Incorporated
25 Broadway, 12th Floor
New York, NY 10004

Dear Mr. Moore:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Audit of Group Health Incorporated's Final Administrative Cost Proposal for Fiscal Year 2008*. We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me, or contact Richard Schlitt, Audit Manager, at (212) 264-4817 or through email at Richard.Schlitt@oig.hhs.gov. Please refer to report number A-02-09-01026 in all correspondence.

Sincerely,

/James P. Edert/
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor
Acting Director & Chief Financial Officer
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Department of Health & Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF GROUP HEALTH
INCORPORATED'S FINAL
ADMINISTRATIVE COST
PROPOSAL FOR
FISCAL YEAR 2008**



Daniel R. Levinson
Inspector General

April 2011
A-02-09-01026

Office of Inspector General

<http://oig.hhs.gov>

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THIS REPORT IS AVAILABLE TO THE PUBLIC
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Section 8L of the Inspector General Act, 5 U.S.C. App., requires that OIG post its publicly available reports on the OIG Web site.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

Title XVIII of the Social Security Act established the Medicare Program. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part B carriers that process and pay Medicare claims. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

CMS contracts provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and the Medicare contracts. Following the close of each fiscal year (FY), contractors submit to CMS a Final Administrative Cost Proposal (cost proposal), which reports the Medicare administrative costs incurred during the year. The cost proposal and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs.

For FY 2008, CMS contracted with Group Health Incorporated (GHI) to serve as the Medicare Part B carrier for Queens County in New York State. For this period, GHI reported Medicare Part B administrative costs totaling \$13,470,631. However, GHI did not report \$148,168 of additional overhead costs.

OBJECTIVES

Our objectives were to determine whether (1) the GHI cost proposal for FY 2008 fairly presented program administration costs and (2) the costs were reasonable, allowable, and allocable in accordance with the FAR and the Medicare contract provisions.

SUMMARY OF FINDINGS

GHI's reported expenditures in its FY 2008 cost proposal substantially complied with the FAR and the Medicare contract provisions. However, GHI overstated its cost proposal by \$19,665. Specifically, GHI reported unallowable program costs totaling \$57,160 and understated overhead costs by \$37,495.

RECOMMENDATION

We recommend that GHI decrease its cost proposal by \$19,665 (\$57,160 overstated program costs less \$37,495 understated overhead costs) to reflect the unallowable administrative costs.

GROUP HEALTH INCORPORATED COMMENTS

In written comments on our draft report, GHI did not concur with our recommendation to decrease its cost proposal by \$19,665. GHI indicated that, because the period for reporting expenses related to the Medicare contract was truncated, it was unable to curtail expenses or request additional funding from CMS. Specifically, GHI indicated that it could not request additional funding from CMS without a full year of contract spending because CMS cut funding limits on an annualized basis late in the FY. GHI also stated that it could not decrease expenses or utilize other measures to reduce spending in the final 2 months of the FY. Finally, GHI indicated that the unclaimed overhead costs of \$148,168 should be used to offset the \$19,665 in overstated costs.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing GHI's comments, we maintain that our findings and recommendation are valid. We determined that \$37,495 of the \$148,168 in unreported overhead costs were allowable for Medicare reimbursement and, in determining our recommended adjustment of \$19,665, subtracted this amount from GHI's unallowable program costs (\$57,160). GHI's comments are included in their entirety as Appendix D.

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INTRODUCTION

BACKGROUND

Title XVIII of the Social Security Act established the Medicare Program. The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program through contractors, including Part B carriers that process and pay Medicare claims. Contracts between CMS and the Medicare contractors define the functions to be performed and provide for the reimbursement of allowable administrative costs incurred in the processing of Medicare claims.

CMS contracts provide for the reimbursement of allowable administrative costs incurred in processing Medicare claims. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and the Medicare contracts. Following the close of each fiscal year (FY), contractors submit to CMS a Final Administrative Cost Proposal (cost proposal), which reports the Medicare administrative costs incurred during the year. The cost proposal and supporting data provide the basis for the CMS contracting officer and contractor to negotiate a final settlement of allowable administrative costs.

For FY 2008, CMS contracted with Group Health Incorporated (GHI) to serve as the Medicare Part B carrier for Queens County in New York State. For this period, GHI reported Medicare Part B administrative costs totaling \$13,470,631. However, GHI did not report \$148,168 of additional overhead costs.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine whether (1) the GHI cost proposal for FY 2008 fairly presented program administration costs and (2) the costs were reasonable, allowable, and allocable in accordance with the FAR and the Medicare contract provisions.

Scope

Our review covered the period October 1, 2007, through July 18, 2008 (the date CMS terminated its contract with GHI). For this period, GHI reported Medicare Part B administrative costs totaling \$13,470,631. This total includes transition and termination costs totaling \$4,213,738; and pension costs totaling \$522,402 that we excluded from this review because they will be the subject of separate audits. GHI also did not report overhead costs totaling \$148,168. We reviewed \$8,882,659 of Part B administrative costs, including the unreported overhead costs. GHI did not report any forward-funding costs in its cost proposal for this period. We reviewed only those internal controls necessary to achieve our objectives.

We conducted fieldwork at GHI's offices in New York, New York, from September 2009 through July 2010.

Methodology

To accomplish our objectives, we:

- reviewed applicable Medicare laws, regulations, and guidelines;
- reviewed the applicable sections of the FAR and GHI's contract with CMS;
- reviewed GHI's independent auditor's report on its financial statements for calendar years (CY) 2007 and 2008 and the independent auditor's letter related to its consideration of GHI's internal controls for CY 2008;
- reviewed CMS risk assessment reports and CMS closing agreements for FYs 2000 through 2007;
- reconciled expenses on the cost proposal and cost classification reports to GHI's accounting records;
- tested costs for reasonableness, allowability and allocability;
- selected and reviewed a judgmental sample of journal entries, invoices, expense vouchers and reports, contracts and agreements, and additional supporting documentation;
- interviewed GHI officials to gain an understanding of GHI's cost accumulation processes and cost allocation systems;
- reviewed payroll and personnel records; and
- selected a judgmental sample of 30 individual employees and verified that the amount paid to each employee was in accordance with the employee's pay rate, the employee's salary was charged to the correct cost center, and the number of hours paid agreed with the employee's time reports.

In addition, for the top five executive salaries allocated to Medicare, we:

- reviewed total compensation payout data and supporting documentation for FY 2008;
- compared executive compensation costs to benchmark amounts published in the Federal Register for FY 2008; and
- applied the Medicare allocation percentage to each executive's total compensation, up to the benchmark amount, to determine the allowable executive compensation amount.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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 findings and conclusions based on our audit objectives.

FINDINGS AND RECOMMENDATION

GHI's reported expenditures in its FY 2008 cost proposal substantially complied with the FAR and the Medicare contract provisions. However, GHI overstated its cost proposal by \$19,665. Specifically, GHI reported unallowable program costs totaling \$57,160 and understated overhead costs by \$37,495.

OVERSTATED PROGRAM COSTS

GHI reported unallowable Medicare Integrity Program (MIP) provider outreach and education costs totaling \$57,160.

The Medicare contract states that CMS will issue a Notification of Budget Approval (NOBA) to notify contractors of the amount of funds approved and certified to be available for the fiscal year. Contractors cannot exceed the annual amount on the NOBA without prior approval.¹ Further, section 4261 of CMS's Carrier Manual states that contractors are not authorized to incur expenses in excess of the total certified amount.

GHI did not monitor its reporting of program costs to ensure compliance with CMS's budget guidelines. As a result, GHI overstated its MIP provider outreach and education costs by \$77,802.² After applying cost savings from other MIP functions, we determined that \$20,642 of the overstated costs were allowable for Medicare reimbursement; however, the remaining \$57,160 was unallowable.

UNDERSTATED OVERHEAD COSTS

GHI understated overhead costs in its cost proposal by \$37,495. This amount represents the allocation of unreported overhead costs incurred during FY 2008.

Section 31-201-1 of the FAR states that the total cost of a contract includes all costs properly allocable to the contract. In addition, the Medicare contract requires the contractor to submit a plan of expenditures in accordance with the reporting requirements of the carrier manual. The carrier manual states that the contractor shall prepare the cost proposal allocated by program management and MIP funds, and should include all Medicare costs incurred during the FY.

¹ CMS budget flexibility guidelines grant contractor's authority to shift funds within its NOBA once issued. Contractors have unlimited flexibility in shifting funds between program management ongoing functions in their NOBA. However, the cumulative amounts shifted to or from any MIP function may not exceed 5 percent of the largest approved amount for that function.

² CMS's NOBA for these costs totaled \$412,831. However, in its cost proposal, GHI claimed costs of \$490,633.

GHI limited its overhead costs billed to the Medicare contract to its budgeted amount.³ We allocated the unreported overhead costs to the appropriate cost proposal functions and determined that \$37,495 of the \$148,168 in unreported overhead costs were allowable for Medicare reimbursement. The remaining \$110,673 exceeded approved budgets and was therefore not allowable for Medicare reimbursement.

RECOMMENDATION

We recommend that GHI decrease its cost proposal by \$19,665 (\$57,160 overstated program costs less \$37,495 understated overhead costs) to reflect the unallowable administrative costs.

GROUP HEALTH INCORPORATED COMMENTS

In written comments on our draft report, GHI did not concur with our recommendation to decrease its cost proposal by \$19,665. GHI indicated that, because the period for reporting expenses related to the Medicare contract was truncated, it was unable to curtail expenses or request additional funding from CMS. Specifically, GHI indicated that it could not request additional funding from CMS without a full year of contract spending because CMS cut funding limits on an annualized basis late in the FY. GHI also stated that it could not decrease expenses or utilize other measures to reduce spending in the final 2 months of the FY. Finally, GHI indicated that the unclaimed overhead costs of \$148,168 should be used to offset the \$19,665 in overstated costs.

OFFICE OF INSPECTOR GENERAL RESPONSE

After reviewing GHI's comments, we maintain that our findings and recommendation are valid. We determined that \$37,495 of the \$148,168 in unreported overhead costs were allowable for Medicare reimbursement and, in determining our recommended adjustment of \$19,665, subtracted this amount from GHI's unallowable program costs (\$57,160). GHI's comments are included in their entirety as Appendix D.

³ GHI monitored monthly overhead costs and, if the projected fiscal year overhead costs exceed the budgeted amount, GHI absorbed the corporate allocation of overhead cost for that month. These absorbed costs were not reported on the cost proposal.

APPENDIXES

**APPENDIX A: COSTS REPORTED ON FINAL ADMINISTRATIVE
COST PROPOSAL BY COST CLASSIFICATION**

Cost Category	Total Costs Claimed
Salaries/Wages	\$7,787,580
Fringe benefits	2,245,826
Facilities or Occupancy	2,107,309
EDP Equipment	107,123
Subcontracts	10,677
Outside Professional Services	368,961
Telephone and Telegraph	16,714
Postage and Express	452,251
Furniture and Equipment	300,606
Materials and Supplies	352,877
Travel	15,212
Return on Investment	0
Miscellaneous	168,183
Other	0
Subtotal	\$13,933,319
Credits	(462,688)
Subtotal	\$13,470,631
Forward Funding	0
Total Reported Costs	\$13,470,631 ¹
Costs Not Reviewed	(4,736,140) ²
Total Reported Costs Reviewed	\$8,734,491 ³
OIG Recommended Adjustments	(19,665) ⁴
Total Adjusted Costs	\$8,714,826

¹ GHI had \$148,168 of unreported overhead costs.

² This amount consists of \$4,213,738 of transition and termination costs, and \$522,402 of pension costs.

³ Total reviewed costs were \$8,882,659, including unreported overhead costs.

⁴ See Appendix B.

**APPENDIX B: OFFICE OF INSPECTOR GENERAL
RECOMMENDED COST ADJUSTMENTS**

Finding Category	Total Part B Adjustments
Overstated program costs	\$(57,160)
Understated overhead costs	37,495
Total OIG Recommended Adjustments	\$(19,665)

**APPENDIX C: COMPARISON OF ADMINISTRATIVE COSTS
REPORTED TO BUDGET AUTHORIZATION**

Operation	Budget Authorization	Administrative Costs Reported	Variance Favorable (Unfavorable)
<u>Program Management</u>			
Bills/Claims Payment	\$4,822,520	\$4,913,896	\$(91,376)
Appeals/Reviews	406,179	407,720	(1,541)
Beneficiary Inquiries	117,550	116,412	1,138
Participating Physician	346,652	339,585	7,067
Provider Enrollment	492,707	430,549	62,158
Provider Telephone Inquiries	1,708,493	1,687,818	20,675
Provider Outreach and Education	94,472	94,790	(318)
Credits	(441,871)	(462,688)	20,817
Subtotal	\$7,546,702	\$7,528,082	\$18,620
<u>Medicare Integrity Program</u>			
Medical Review	\$1,032,953	\$906,722	\$126,231
MSP – Prepayment	146,907	130,471	16,436
Benefit Integrity	75,441	70,837	4,604
MSP – Post payment	146,469	130,148	16,321
MIP – Provider Outreach and Education	412,831	490,633	(77,802)
Subtotal	\$1,814,601	\$1,728,811	\$85,790
Total	\$9,361,303	\$9,256,893	\$104,410

Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 3) and Notification of Budget Approval (Supplement No. 11)

APPENDIX D: GROUP HEALTH INCORPORATED COMMENTS



March 30, 2011

Mr. James P. Edert
Regional Inspector General for Audit Services
Office of Inspector General
Office of Audit Services
Region II, Jacob Javits Federal Building
26 Federal Plaza – Room 3900
New York, N.Y. 10278

Re: OIG Report March 2011, A-02-09-01026

Dear Mr. Edert:

This response is in regard to the subject DRAFT report. We do not concur with the \$19,665 financial finding as discussed below. The main reasons are that the year was truncated in July 2008, so GHI did not have the ability to curtail expenses and/or request additional funding had a full fiscal year been available, and that there are other overhead costs that were not claimed that should offset the financial finding.

In years past, GHI was able to request and was granted approval for additional funding during the latter months of the fiscal year. Without the full year contract spending, this was not an option since the funding limits were cut on an annualized basis late in the year. Moreover, had GHI had the same opportunity to curtail expenses, GHI could have decreased Other Direct Costs, reassigned or terminated staff earlier, and utilized other measures to reduce spending in the final 2 months of the year.

GHI's focus at this critical time at the end of the contract that was in existence since 1966 was to ensure a smooth transition to the successor Contractor. The transition that took place in July 2008 was problem free and the incoming contractor was not left with huge backlogs because of that concerted focus. GHI should not be penalized for its good faith efforts in maintaining the business while winding down operations.

In addition, as stated in the DRAFT report, Overhead costs in the amount of \$148,168 were not claimed by GHI in FY 2008. In prior audits, all of these costs were used to offset any financial findings. We believe the OIG should continue with this precedent and the \$19,665 should be offset by the higher amount of unclaimed costs.

Sincerely,

A handwritten signature in black ink that reads "Peter S. Moore". The signature is written in a cursive, flowing style.

Peter S. Moore
Vice President

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www.ghimedicare.com