



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

May 25, 2011

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

Report Number: A-02-09-01039

Ms. Suzanne M. Gannon  
CFO, Medicare Operation  
MedUS Services, LLC  
HealthNow New York, Inc.  
257 West Genesee Street  
Buffalo, NY 14202

Dear Ms. Gannon:

Enclosed is the U.S. Department of Health & Human Services (HHS), Office of Inspector General (OIG), final report entitled *Audit of HealthNow New York, Inc.'s Medicare Part B 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](mailto:Richard.Schlitt@oig.hhs.gov). Please refer to report number A-02-09-01039 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  
Office of Financial Management  
Centers for Medicare & Medicaid Services  
Mail Stop C3-01-24  
7500 Security Boulevard  
Baltimore, MD 21244-1850

**Department of Health & Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF HEALTHNOW  
NEW YORK, INC.'S MEDICARE  
PART B FINAL ADMINISTRATIVE  
COST PROPOSAL FOR  
FISCAL YEAR 2008**



**Daniel R. Levinson  
Inspector General**

**May 2011  
A-02-09-01039**

# ***Office of Inspector General***

<http://oig.hhs.gov>

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The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health & Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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# *Notices*

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## **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 HealthNow New York, Inc. (HealthNow) to serve as the Medicare Part B carrier for 45 counties in upstate New York. For this period, HealthNow reported Medicare Part B administrative costs totaling \$15,551,803, which included \$850,571 in transition costs.

In 2008, CMS awarded a Medicare Administrative Contract for the region covered by HealthNow to National Government Services, Inc. (NGS), resulting in the transition of responsibilities under the Part B contract from HealthNow to NGS on September 1, 2008.

### **OBJECTIVES**

Our objectives were to determine whether (1) the HealthNow 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.

### **SUMMARY OF FINDINGS**

HealthNow's reported expenditures in its FY 2008 cost proposal substantially complied with the FAR and the Medicare contract. However, HealthNow overstated its cost proposal by \$18,668. Specifically, HealthNow overstated its return on investment by \$11,283 and reported unallocable subcontract costs (\$4,174), as well as unallowable public relations and advertising costs (\$3,211).

### **RECOMMENDATION**

We recommend that HealthNow decrease its cost proposal by \$18,668 to reflect the unallowable administrative costs.

## **HEALTHNOW COMMENTS**

In written comments on our draft report, HealthNow agreed with our findings. HealthNow's comments appear 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 HealthNow New York, Inc. (HealthNow) to serve as the Medicare Part B carrier for 45 counties in upstate New York.<sup>1</sup> For this period, HealthNow reported Medicare Part B administrative costs totaling \$15,551,803, which included \$850,571 in transition costs. (See Appendix A.)

In 2008, CMS awarded a Medicare Administrative Contract for the region covered by HealthNow to National Government Services, Inc. (NGS), resulting in the transition of responsibilities under the Part B contract from HealthNow to NGS on September 1, 2008.

### **OBJECTIVES, SCOPE, AND METHODOLOGY**

#### **Objectives**

Our objectives were to determine whether (1) the HealthNow 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.

#### **Scope**

Our review covered the period October 1, 2007, through August 31, 2008 (the date CMS terminated its contract with HealthNow). For this period, HealthNow reported Medicare Part B administrative costs totaling \$15,551,803, which included \$850,571 in transition costs. These costs also included pension costs totaling \$4,833 that we excluded from this review because they will be the subject of a separate audit.<sup>2</sup> HealthNow did not report any forward-funding costs in

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<sup>1</sup> Upstate Medicare Division, a division of HealthNow, processed the Part B claims.

<sup>2</sup> We will also be issuing a separate report (A-02-11-01020) on cost submitted by Health Now related to the termination of the Medicare contract.

its cost proposal for this period. We reviewed only those internal controls necessary to achieve our audit objectives.

We conducted fieldwork at HealthNow's office in Buffalo, New York.

## **Methodology**

To accomplish our objectives, we:

- reviewed applicable Medicare laws, regulations, and guidelines;
- reviewed the applicable sections of the FAR and HealthNow's contract with CMS;
- reviewed HealthNow'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 HealthNow's internal controls for CY 2008;
- reviewed a prior Office of Inspector General audit report;<sup>3</sup>
- reconciled expenses on the cost proposals and cost classification reports to HealthNow'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 HealthNow officials to gain an understanding of HealthNow's cost accumulation processes and cost allocation systems;
- reviewed payroll journals, corporate bonus plans, 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.

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<sup>3</sup> *Audit of HealthNow New York, Inc's, Medicare Part B Final Administrative Cost Proposals for Fiscal Years 2005 Through 2007 (A-02-08-01003).*

In addition, for each of the five highest paid HealthNow executives who had salaries allocated to Medicare, we:

- traced employee data from HealthNow's year-end payroll registers to the executive's Form W-2;
- reviewed total compensation payout data and supporting documentation;
- compared executive compensation costs to benchmark amounts published in the Federal Register; and
- applied the Medicare allocation percentage to the 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**

HealthNow's reported expenditures in its FY 2008 cost proposal substantially complied with the FAR and the Medicare contract provisions. However, HealthNow overstated its cost proposal by \$18,668. Specifically, HealthNow overstated its return on investment by \$11,283 and reported unallocable subcontract costs (\$4,174), as well as unallowable public relations and advertising costs (\$3,211). (See Appendix B.)

### **OVERSTATED RETURN ON INVESTMENT**

Pursuant to section X.A of Appendix B of the Medicare contract, return on investment shall be determined by "multiplying the average undepreciated balance of such assets for the contract period by the actual rate of return of the contractor's investment portfolio for the contract period, or a lower rate if the contractor so chooses."

To calculate its return on investment, HealthNow used the rate of return of its investment portfolio for FY 2007 instead of the rate for the contract period (FY 2008). HealthNow officials informed us that this was due to a clerical error. We recalculated the return on investment using the FY 2008 rate of return and determined that HealthNow overstated this cost on its cost proposal by \$11,283.

## **UNALLOCABLE SUBCONTRACT COSTS**

Pursuant to section 31.204(a) of the FAR, costs are allowable to the extent they are reasonable, allocable, and determined to be allowable. Further, section 31.201-4 of the FAR states that “a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.”

HealthNow reported \$4,174 in non-Medicare related subcontract costs on its cost proposal. HealthNow officials informed us that this was due to a clerical error.

## **UNALLOWABLE PUBLIC RELATIONS AND ADVERTISING COSTS**

Pursuant to section 31-205-1(f)(7) of the FAR, public relations and advertising costs are unallowable, including “costs of memberships in civic and community organizations.” Further, pursuant to section 31.205-22 of the FAR, lobbying and political activity costs are unallowable.

HealthNow reported unallowable costs totaling \$3,211 on its cost proposal related to membership dues to a civic group that advocates for improving the upstate New York business climate. Among other activities, the group provides lobbying, political advocacy and government relations support.

## **RECOMMENDATION**

We recommend that HealthNow decrease its cost proposal by \$18,668 to reflect the unallowable administrative costs.

## **HEALTHNOW COMMENTS**

In written comments on our draft report, HealthNow agreed with our findings. HealthNow’s comments appear in their entirety as Appendix D.

# **APPENDIXES**

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

<u>Cost Category</u>	<u>Amount</u>
Salaries/Wages	\$7,977,694
Fringe benefits	3,535,244
Facilities or Occupancy	1,664,263
EDP Equipment	970,125
Subcontracts	2,088,646
Outside Professional Services	108,121
Telephone and Telegraph	133,871
Postage and Express	1,268,623
Furniture and Equipment	514,632
Materials and Supplies	138,545
Travel	66,270
Return on Investment	17,194
Miscellaneous	326,779
Other	2,156
Subtotal	<u>\$18,812,163</u>
Other Adjustments (Credits)	<u>(3,260,360)</u>
Total Costs	\$15,551,803
Forward Funding	<u>0</u>
<b>Total Costs Reported</b>	<b><u>\$15,551,803</u></b>

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

<u>Finding Category</u>	<u>Adjustments</u>
Overstated Return on Investment	\$11,283
Unallowable Subcontract Costs	4,174
Unallowable Public Relations And Advertising Costs	3,211
<b>OIG Recommended Adjustments</b>	<b><u><u>\$18,668</u></u></b>

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

<u>Operation</u>	<u>Budget Authorization</u>	<u>Administrative Costs Claimed</u>	<u>Variance Favorable (Unfavorable)</u>
<b><u>Program Management</u></b>			
Bills/Claims Payment	\$11,095,007	\$11,206,931	\$(111,924)
Appeals/Reviews	1,629,606	1,632,227	(2,621)
Beneficiary Inquiries	89,404	57,389	32,015
Participating Physician	46,249	25,918	20,331
Provider Enrollment	1,686,979	1,512,339	174,640
Provider Telephone Inquiries	1,583,126	1,413,006	170,120
Provider Outreach and Educ.	198,898	182,696	16,202
Credits	(3,077,744)	(3,260,360)	182,616
Subtotal	\$13,251,525	\$12,770,146	\$481,379
<b><u>Medicare Integrity</u></b>			
Medical Review	\$1,349,982	\$1,197,487	\$152,495
MSP - Prepayment	168,541	159,009	9,532
Benefit Integrity	15,963	12,981	2,982
MSP - Postpayment	116,110	97,640	18,470
MIP - Prov Outreach and Educ.	485,711	463,969	21,742
Subtotal	\$2,136,307	\$1,931,086	\$205,221
Total without Transition	15,387,832	14,701,232	686,600
Transition	947,360	850,571	96,789
<b>Total</b>	<b>\$16,335,192</b>	<b>\$15,551,803</b>	<b>\$783,389</b>

**Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 3) and Notification of Budget Approval (Supplement No. 12)**

## APPENDIX D: HEALTHNOW COMMENTS



PO Box 80 / Buffalo, New York 14240-0080

April 11, 2011

### **BY OVERNIGHT MAIL**

Mr. James P. Edert  
Office of Inspector General  
Office of Audit Services  
26 Federal Plaza – Room 3900  
New York, New York 10278

Re: Reply to Draft Audit Report for HealthNow New York Inc. #A-02-09-01039

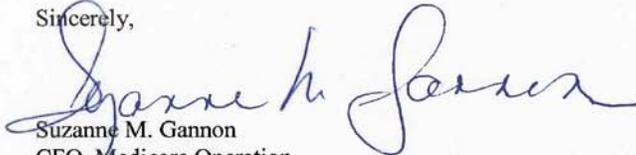
Dear Mr. Edert:

This letter is in response to the draft audit report dated March 25, 2011, for HealthNow New York Inc's ("HealthNow") final Administrative Costs Proposals (FACP) for the Medicare Part B carrier Contract for the period October 1, 2007 through August 31, 2008. The draft audit report requested our comments within 30 days of receipt.

HealthNow has reviewed the draft report. HealthNow agrees with the audit report's findings relating to our computation of the cost of investment; unallowable subcontract costs and public relations and advertising costs. Since HealthNow no longer has a Part B contract a corrective action plan cannot be implemented.

HealthNow would like to thank the audit team for their professionalism and recognition of the ongoing operation during the audit. If there are any questions, please contact me.

Sincerely,



Suzanne M. Gannon  
CFO, Medicare Operation  
MedUS Services, LLC  
HealthNow New York Inc.

Cc: Catherine M. Campbell, HealthNow  
Amy M. Arena, HealthNow  
Carmen L. Snell, HealthNow  
Richard Schlitt, OIG

