



DEPARTMENT OF HEALTH AND HUMAN SERVICES  
OFFICE OF AUDIT SERVICES  
233 NORTH MICHIGAN AVENUE  
CHICAGO, ILLINOIS 60601

REGION V  
OFFICE OF  
INSPECTOR GENERAL

July 29, 2008

Report Number: A-05-08-00046

Michael McCarron  
President  
National Government Services  
8115 Knue Road  
Indianapolis, Indiana 46250

Dear Mr. McCarron:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Audit of Medicare Part A Administrative Costs for the Period October 1, 2005, through September 30, 2006." 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.

Pursuant to the principles of the Freedom of Information Act, 5 U.S.C. § 552, as amended by Public Law 104-231, OIG reports generally are made available to the public to the extent the information is not subject to exemptions in the Act (45 CFR part 5). Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to contact Mike Barton, Audit Manager, at (614) 469-2543 or through e-mail at [Mike.Barton@oig.hhs.gov](mailto:Mike.Barton@oig.hhs.gov). Please refer to report number A-05-08-00046 in all correspondence.

Sincerely,

A handwritten signature in black ink, appearing to read "Marc Gustafson".

Marc Gustafson  
Regional Inspector General  
for Audit Services

Enclosure

**Direct Reply to HHS Action Official:**

Nanette Foster Reilly, Consortium Administrator  
Consortium for Financial Management & Fee for Service Operations  
Centers for Medicare & Medicaid Services  
601 East 12<sup>th</sup> Street, Room 235  
Kansas City, Missouri 64106

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**AUDIT OF MEDICARE PART A  
ADMINISTRATIVE COSTS FOR  
THE PERIOD OCTOBER 1, 2005,  
THROUGH SEPTEMBER 30, 2006**

**UNITED GOVERNMENT SERVICES**



Daniel R. Levinson  
Inspector General

July 2008  
A-05-08-00046

# ***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 and 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:

## ***Office of Audit Services***

The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

## ***Office of Evaluation and Inspections***

The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

## ***Office of Investigations***

The Office of Investigations (OI) conducts criminal, civil, and administrative investigations of fraud and misconduct related to HHS programs, operations, and beneficiaries. With investigators working in all 50 States and the District of Columbia, OI utilizes its resources by actively coordinating with the Department of Justice and other Federal, State, and local law enforcement authorities. The investigative efforts of OI often lead to criminal convictions, administrative sanctions, and/or civil monetary penalties.

## ***Office of Counsel to the Inspector General***

The Office of Counsel to the Inspector General (OCIG) provides general legal services to OIG, rendering advice and opinions on HHS programs and operations and providing all legal support for OIG's internal operations. OCIG represents OIG in all civil and administrative fraud and abuse cases involving HHS programs, including False Claims Act, program exclusion, and civil monetary penalty cases. In connection with these cases, OCIG also negotiates and monitors corporate integrity agreements. OCIG renders advisory opinions, issues compliance program guidance, publishes fraud alerts, and provides other guidance to the health care industry concerning the anti-kickback statute and other OIG enforcement authorities.

# *Notices*

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**THIS REPORT IS AVAILABLE TO THE PUBLIC**  
at <http://oig.hhs.gov>

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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 A fiscal intermediaries (FIs), 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.

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 2006, CMS contracted with United Government Services (UGS) to receive, review, audit, and pay Medicare Part A claims. UGS reported Medicare costs totaling \$102,782,181 in its FY 2006 cost proposal. Effective January 1, 2007, National Government Services assumed the Medicare business operations of UGS.

### **OBJECTIVES**

Our objectives were to determine whether (1) the UGS cost proposal presented fairly the costs of program administration and (2) the costs were reasonable, allowable and allocable in accordance with Federal Acquisition Regulations and other applicable criteria.

### **SUMMARY OF FINDINGS**

UGS reported expenditures in its cost proposal that substantially complied with the Federal Acquisition Regulations and Medicare contract provisions. However, UGS reported unallowable costs totaling \$113,924 because it overstated costs for senior executive compensation (\$113,273) and entertainment (\$651). UGS also reported \$100,001 in legal settlement costs and \$33,611 in non-senior executive compensation costs that may be unreasonable.

UGS did not report any forward-funding costs in the cost proposal. There were no outstanding services reported for which funding was received but services were not rendered during our audit period.

## **RECOMMENDATIONS**

We recommend that National Government Services:

- decrease the cost proposal by
  - \$113,273 to reflect unallowable senior executive compensation costs and
  - \$651 to reflect unallowable entertainment costs; and
- work with the CMS Contracting Officer to determine the reasonableness of
  - costs totaling \$100,001 related to the legal settlement and
  - non-senior executive compensation costs of \$33,611 that exceeded benchmark amounts for senior executive compensation.

## **AUDITEE COMMENTS**

In written comments on our draft report, National Government Services concurred with our findings regarding the unintentional misstatement of allowable executive compensation and unallowable entertainment costs.

National Government Services disagreed with our finding regarding non-senior executive compensation costs because it believes that such costs are reasonable and conform to the meaning, intent and requirements of FAR 31.205-6. National Government Services also disagreed with our finding related to legal settlement costs that may be unreasonable. National Government Services stated that it will work with the CMS Contracting Officer to determine the reasonableness of these costs. National Government Services' comments are included as Appendix D.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

While National Government Services disagreed with our findings regarding non-senior executive compensation and legal settlement costs, it agreed with our recommendation to work with the CMS Contracting Officer to determine the reasonableness of the costs. We will provide a copy of this report to the CMS contracting officer for use in making a final determination as to the reasonableness of the costs.

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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 A fiscal intermediaries (FIs), 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.

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 2006, CMS contracted with United Government Services (UGS) to receive, review, audit, and pay Medicare Part A claims. UGS reported Medicare costs totaling \$102,782,181 in its FY 2006 cost proposal. Effective January 1, 2007, National Government Services assumed the Medicare business operations of UGS.

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

#### **Objectives**

Our objectives were to determine whether (1) the UGS cost proposal presented fairly the costs of program administration and (2) the costs were reasonable, allowable and allocable in accordance with Federal Acquisition Regulations (FAR) and other applicable criteria.

#### **Scope**

Our review covered the period October 1, 2005, through September 30, 2006. We reviewed the internal controls that UGS had in place to allocate costs in accordance with the FAR and the Medicare contract. This understanding was for the purpose of accomplishing our objectives and not to provide assurance on the internal control structure.

For FY 2006, UGS reported Medicare costs totaling \$102,782,181. This total included pension costs of \$1,171,422 that we excluded from this review because they will be the subject of a separate audit. UGS did not report any forward-funding costs in the cost proposal.

We conducted fieldwork at UGS's office in Milwaukee, Wisconsin.

## **Methodology**

To accomplish the objectives, we:

- reviewed applicable Medicare laws, regulations, and guidelines, as well as UGS's contracts with CMS;
- reviewed the independent auditor's reports for FY 2002 and 2003, and prior OIG audit reports for FY 1999 through 2001 and FY 2004 through FY 2005 for UGS;
- reconciled line item expenses on the cost proposal and cost classification report to the contractor's subsidiary expense records by cost center and account;
- reconciled the cost proposal to UGS's accounting records;
- gained an understanding of UGS's cost allocation systems;
- reviewed invoices, journal entries, and expense reports;
- reviewed supporting documentation for the compensation of the top five executives of UGS's parent company and the top five executives in the Medicare segments;
- reviewed all executives' total compensation payout data for each fiscal year and the amount allocated to the Medicare program;
- compared senior and non-senior executive compensation costs to benchmark compensation amounts published in the Federal Register for FYs 2005 and 2006;
- applied the Medicare allocation percentage to each executive's compensation, up to the benchmark limit, to determine the allowable executive compensation amount;
- identified UGS's estimated unallowable executive compensation costs included in the cost proposal by fiscal year; and
- tested costs for allocability, reasonableness, and allowability.

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 RECOMMENDATIONS**

UGS reported expenditures in its cost proposal that substantially complied with the Federal Acquisition Regulations and Medicare contract provisions. However, UGS reported unallowable costs totaling \$113,924 because it overstated costs for senior executive compensation (\$113,273) and entertainment (\$651). UGS also reported \$100,001 in legal settlement costs and \$33,611 in non-senior executive compensation costs that may be unreasonable.

### **UNALLOWABLE COSTS**

UGS reported unallowable costs totaling \$113,924 because it overstated costs for executive compensation (\$113,273) and entertainment (\$651).

#### **Overstated Senior Executive Compensation Costs**

UGS overstated senior executive compensation costs by \$113,273.

FAR 31.205-6 (p) states, “Costs incurred after January 1, 1998, for compensation of a senior executive in excess of the benchmark compensation amount determined applicable for the contractor fiscal year by the Administrator, Office of Federal Procurement Policy (OFPP), under Section 39 of the OFPP Act (41 U.S.C. 435) are unallowable.” Effective January 2, 1999, senior executive means, “The five most highly compensated employees in management positions at each home office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor’s headquarters.”

The actual benchmark compensation amount for each fiscal year is published in the Federal Register. This benchmark compensation amount applies to contract costs incurred after January 1 of that year. The maximum benchmark compensation amounts allowable under government contracts during fiscal years 2005 and 2006 were \$473,318,<sup>1</sup> and \$546,689,<sup>2</sup> respectively.

UGS estimated unallowable senior executive compensation costs on the cost proposal by including in the cost proposal a credit amount that reduced the amount reported for executive compensation. Estimated amounts must be adjusted after actual expenses are incurred.

UGS estimated unallowable senior executive compensation amounts of \$111,654. However, actual unallowable senior executive compensation costs were \$224,927. The difference of \$113,273 represents the outstanding amount of unallowable senior executive compensation costs.

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<sup>1</sup>70 Federal Register 23888 (May 5, 2005)

<sup>2</sup>71 Federal Register 26114 (May 3, 2006)

## **Entertainment Costs**

UGS reported \$651 for unallowable entertainment costs in its cost proposal.

FAR 31.205-14 states that "Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle."

UGS allocated \$651 to the Medicare contract for gift cards purchased to celebrate the successful completion of conversion code testing and a meal purchased as a reward for those that participated in the successful completion of a phase of the Healthcare Integrated General Ledger Accounting System (HIGLAS) project. These costs were not allocable to the Medicare contract and are, therefore unallowable.

## **POTENTIALLY UNREASONABLE COSTS**

UGS reported \$100,001 in legal settlement costs and \$33,611 in non-senior executive compensation costs that may be unreasonable. We are setting aside these costs for the CMS contracting officer to review for reasonableness.

### **Legal Settlement Costs**

UGS reported an expense of \$100,001 for a legal settlement in its cost proposal. The settlement was awarded in a wrongful termination dispute. Although certain legal settlement costs may be claimed for reimbursement, we were unable to determine the reasonableness of the settlement amount and are setting it aside for the CMS contracting officer to review.

### **Non-Senior Executive Compensation Costs**

UGS reported non-senior executive compensation costs that may be unreasonable because the costs exceeded maximum benchmark amounts for senior executive compensation by \$33,611.

FAR 31.205-6(b)(2) states, "Compensation for each employee or job class of employees must be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation, consider only allowable individual elements of compensation. In addition to the provisions of 31.203-3, in testing the reasonableness of compensation for particular employees or job classes of employees, consider factors determined to be relevant by the contracting officer...."

Since maximum benchmark compensation amounts for non-senior executive compensation have not been established, we compared amounts allowable under

government contracts for senior executive compensation to all non-senior executives allocating costs to Medicare to determine the reasonableness of the costs.

UGS allocated \$107,547 of non-senior executive compensation costs to the cost proposal. However, the non-senior executive compensation costs exceeded the maximum benchmark amounts for senior executive compensation by \$33,611. We are setting aside this cost for the CMS contracting officer to review for reasonableness.

## **RECOMMENDATIONS**

We recommend that National Government Services:

- decrease the cost proposal by
  - \$113,273 to reflect unallowable senior executive compensation costs and
  - \$651 to reflect unallowable entertainment costs; and
- work with the CMS Contracting Officer to determine the reasonableness of
  - costs totaling \$100,001 related to the legal settlement and
  - non-senior executive compensation costs of \$33,611 that exceeded benchmark amounts for senior executive compensation.

## **AUDITEE COMMENTS**

In written comments on our draft report, National Government Services concurred with our findings regarding the unintentional misstatement of allowable executive compensation and unallowable entertainment costs.

National Government Services disagreed with our finding regarding non-senior executive compensation costs because it believes that such costs are reasonable. National Government Services believes its compensation and related increases conform to the meaning, intent and requirements of FAR 31.205-6. National Government Services also disagreed with our finding related to legal settlement costs that may be unreasonable. National Government Services stated that it will work with the CMS Contracting Officer to determine the reasonableness of these costs.

National Government Services' comments are included as Appendix D.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

While National Government Services disagreed with our findings regarding non-senior executive compensation and legal settlement costs, it agreed with our recommendation to work with the CMS Contracting Officer to determine the reasonableness of the costs. We will provide a copy of this report to the CMS contracting officer for use in making a final determination as to the reasonableness of the costs.

# **APPENDIXES**

**COSTS CLAIMED ON FINAL ADMINISTRATIVE COST PROPOSAL BY  
COST CLASSIFICATION  
October 1, 2005, Through September 30, 2006**

<b>Category</b>	<b><u>FY 2006</u></b>
Salaries & Wages <sup>1</sup>	\$63,178,742
Fringe Benefits	16,338,190
Facility or Occupancy	6,126,669
EDP Equipment	3,182,002
Subcontracts	5,222,795
Outside Professional Services	2,777,532
Telephone & Telegraph	1,363,889
Postage & Express	3,380,600
Furniture/Equipment	70,745
Materials/Supplies	902,745
Travel	1,478,170
Return on Investment	182,345
Miscellaneous	472,646
Other	3,116,958
Credits	(5,011,847)
Forward Funding	<u>0</u>
<b>Total</b>	<b>\$102,782,181</b>

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<sup>1</sup>UGS estimated unallowable senior executive compensation costs within this category.

**UNITED GOVERNMENT SERVICES  
OIG Recommended Cost Disallowance and Set Aside  
For The Fiscal Year 2006**

<u>Finding Categories</u>	<u>Disallowance</u>	<u>Set Aside</u>
Executive Compensation	\$ 113,273	\$ 33,611
Entertainment Expense	651	0
Legal Settlement	0	100,001
<b>Total</b>	<b>\$ 113,924</b>	<b>\$ 133,612</b>

**UNITED GOVERNMENT SERVICES  
Final Administrative Cost Proposal - Part A**

**FY 2006 Comparison of Administrative Costs Claimed 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	\$26,394,709	\$26,067,417	\$327,292
Appeals/Reviews	6,280,700	6,429,160	(148,460)
Bene Inquiries	3,135,000	3,144,461	(9,461)
PM Provider Communication	190,400	200,905	(10,505)
Reimbursement	5,356,000	5,359,704	(3,704)
Provider Enrollment	2,804,100	2,849,186	(45,086)
Provider Telephone Inquiries	3,661,600	3,615,358	46,242
Credits	(4,282,500)	(5,011,847)	729,347
Subtotal- Program Management	\$43,540,009	\$42,654,344	\$885,665
<b><u>Medicare Integrity Program</u></b>			
Medical Review	\$8,429,300	\$8,608,626	(\$179,326)
MSP Prepayment	795,700	798,237	(2,537)
Benefits Integrity	91,100	86,882	4,218
Local Prov Educ & Training	1,961,000	1,852,785	108,215
Provider Communications	1,238,900	1,280,978	(42,078)
Audit	34,592,200	34,791,950	(199,750)
MIP Prod Investment	0	142,509	(142,509)
MSP Postpayment	9,313,400	9,715,870	(402,470)
Subtotal- Medicare Integrity Prog.	\$56,421,600	\$57,277,837	(\$856,237)
HIGLAS	2,850,000	2,850,000	0
<b>Total</b>	<b>\$102,811,609</b>	<b>\$102,782,181</b>	<b>\$29,428</b>

**Note: All amounts were taken from Final Administrative Cost Proposal (Supplement No. 12) and Notice of Budget Approval (Supplement No. 16).**



National Government Services, Inc.  
9901 Lin Station Road  
Louisville, Kentucky 40223  
A CMS Contracted Agent

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glenn.rhodes@antham.com

Mr. Marc Gustafson  
Regional Inspector General for Audit Services  
DHHS-OIG Office of Audit Services  
233 North Michigan Avenue  
Chicago, Illinois 60601

July 14, 2008

Reference: **Report Number A-05-08-00046**

Dear Mr. Gustafson:

We are in receipt of the draft audit report from the Inspector General entitled "Audit of Medicare Part A Administrative Costs for the Period October 1, 2005, through September 30, 2006" pertaining to United Government Services. As noted in the "Executive Summary" section of your report, the UGS Medicare contract was novated to National Government Services (NGS) effective January 1, 2007 thus NGS is responding to this draft report.

We concur with the findings regarding the unintentional misstatement of allowable senior executive compensation and unallowable entertainment costs. We disagree with the finding regarding non-senior executive compensation costs that may be unreasonable as we believe such costs are reasonable within the context of normal and prudent business practices, industry norms, as well as geographic norms. We believe that our compensation and related increases conform to the meaning, intent and requirements of FAR 31.205-6. NGS also disagrees with the finding related to legal settlement costs that may be unreasonable, and which were awarded in a wrongful termination dispute. Upon receipt of the final audit report, NGS will work with the CMS Contracting Officer to determine the reasonableness of these costs.

We appreciate the opportunity to respond to the draft audit report which we believe validates that our administrative expenses for the period reviewed were reasonable, allocable and allowable.

Sincerely,

Glenn Rhodes  
Chief Financial Officer

- cc: Sandra Miller
- Jeff Hannah
- Wendy Perkins
- Opal Nealy -- CMS Chicago