



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office Of Inspector General  
Office Of Audit Services

Region II  
Jacob K. Javits Federal Building  
26 Federal Plaza  
New York, NY 10278

November 12, 2003

Report Number: A-02-03-01012

Ms. Donna M. Przybysz  
Vice President and Chief Operating Officer  
HealthNow New York, Inc.  
Upstate Medicare Division  
33 Lewis Road  
P.O. Box 5236  
Binghamton, New York 13902-5236

Dear Ms. Przybysz:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) report entitled "REVIEW OF MEDICARE PART B ADMINISTRATIVE COSTS CLAIMED BY HEALTHNOW NEW YORK, INC. FOR THE PERIOD OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2002." A copy of this report will be forwarded to the action official noted below for his/her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action 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.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5.)

To facilitate identification, please refer to report number A-02-03-01012 in all correspondence.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Timothy J. Horgan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Timothy J. Horgan  
Regional Inspector General  
for Audit Services

Enclosures

**Direct Reply to HHS Action Official:**

James T. Kerr

Regional Administrator

Centers for Medicare and Medicaid Services – Region II

26 Federal Plaza, Room 3811

New York, NY 10278

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE PART B ADMINISTRATIVE  
COSTS CLAIMED BY  
HEALTHNOWNEW YORK, INC.  
FOR THE PERIOD  
OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2002**



**Inspector General**

**November 2003**

**A-02-03-01012**

# *Office of Inspector General*

<http://oig.hhs.gov/>

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The OIG's Office of Audit Services (OAS) provides all 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 in order to reduce waste, abuse, and mismanagement and to promote economy and efficiency throughout the Department.

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## *Office of Counsel to the Inspector General*

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Ms. Donna M. Przybysz  
Vice President and Chief Operating Officer  
HealthNow New York, Inc.  
Upstate Medicare Division  
33 Lewis Road  
P.O. Box 5236  
Binghamton, New York 13902-5236

Dear Ms. Przybysz:

This report provides you with the results of our audit entitled, "REVIEW OF MEDICARE PART B ADMINISTRATIVE COSTS CLAIMED BY HEALTHNOW NEW YORK, INC. FOR THE PERIOD OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2002."

The objectives of our audit were to determine whether: (1) HealthNow New York, Inc. (HealthNow) has established effective systems of internal controls, accounting and reporting for administrative costs incurred under the program, and (2) the Final Administrative Cost Proposal (FACP) presents fairly, in all material respects, the costs of program administration allowable in accordance with Part 31 of the Federal Acquisition Regulations (FAR) as interpreted and amended by Appendix B of HealthNow's Medicare agreement with the Centers for Medicare & Medicaid Services (CMS).

HealthNow claimed \$64,619,371 on the FACP during our audit period. This included pension costs of \$2,927,812, which will be the subject of a separate audit and therefore, were excluded from the scope of our review.

We determined that HealthNow generally had established adequate systems for internal control, accounting and reporting for administrative costs. In addition, nothing came to our attention to indicate any material control weaknesses. Further, the administrative costs claimed on the FACP for the period October 1, 1999 through September 30, 2002, were generally in accordance with Part 31 of the FAR and Appendix B of HealthNow's Medicare agreement with CMS. However, our review disclosed that \$317,593 of the costs claimed on the FACP for our audit period were overstated. Our findings are summarized below and discussed in detail in the Findings and Recommendations section of this report. We found that:

- ❖ \$143,359 of complementary insurance credits were not allocated to the Medicare program,
- ❖ \$128,976 of Medicare Integrity Program (MIP) costs exceeded the Notice of Budget Approval (NOBA),
- ❖ \$42,075 of increases in executive compensation were excessive,
- ❖ \$1,494 of computer software was incorrectly expensed rather than depreciated, and
- ❖ \$1,689 of claimed public relations and advertising costs was unallowable.

We recommend that HealthNow reduce costs claimed on the FACPs for the period October 1, 1999 through September 31, 2002, by \$317,593 and correct the procedures, which resulted in the applicable findings.

HealthNow concurred with our findings relating to complementary insurance credits, costs exceeding the NOBA and public relations and advertising costs, HealthNow however, did not concur with our remaining two findings. In response to our finding on executive compensation, HealthNow did not agree with our methodology for determining reasonableness of executive salary increases and questioned the inclusion of certain employees in our assessment. With regard to our finding on computer software, HealthNow felt that expensing rather than depreciating these items was appropriate. We disagree with HealthNow's position in both these findings. The Contractor's complete response is included the Appendix.

## **INTRODUCTION**

### **Background**

The Social Security Amendments of 1965 established the Medicare program under Title XVIII of the Social Security Act. The Centers for Medicare & Medicaid Services (CMS), an operating division of the Department of Health and Human Services, is the Federal agency that administers the Medicare program. To meet program objectives, CMS enters into contracts with private companies to process and pay claims for services provided by health care providers to eligible beneficiaries. The contracts provide for reimbursement of allowable administrative costs incurred by intermediaries that process Part A hospital claims and carriers that process Part B medical claims. Contractors claim reimbursement of administrative costs through submission of a Final Administrative Cost Proposal to CMS.

HealthNow, as the Medicare Part B carrier for 45 counties in upstate New York, contracted with CMS, during the period October 1, 1999 through September 30, 2002. For fiscal years 2000 through 2002, HealthNow claimed \$64,619,371 of administrative costs as follows:

<u>Fiscal Year</u>	<u>Costs Claimed</u>
2000	\$21,732,924
2001	21,067,149
2002	<u>21,819,298</u>
Total	<u>\$64,619,371</u>

## **Objectives, Scope and Methodology**

The objectives of our audit were to determine whether: (1) HealthNow has established effective systems of internal controls, accounting and reporting for administrative costs incurred under the program, and (2) the Final Administrative Cost Proposal (FACP) presents fairly, in all material respects, the costs of program administration allowable in accordance with Part 31 of the Federal Acquisition Regulations (FAR) as interpreted and modified by the Medicare agreements. Pension costs, totaling \$2,927,812, which were included on HealthNow's FACP, will be the subject of a separate audit and therefore have been excluded from the scope of this review.

To accomplish our objectives we: (1) examined applicable laws and regulations; (2) held discussions with HealthNow officials regarding their administrative cost procedures; (3) performed a limited review of internal controls during which we obtained and reviewed the Statements on Auditing Standards (SAS) 70 Report issued March 24, 2000 and the Certification Package for Internal Controls for the Fiscal Year ending September 30, 2002; (4) obtained an understanding of the accounting policies and procedures relevant to the audit objectives; (5) reconciled the Interim Expenditure Report (IER) to the FACP; (6) judgmentally selected invoices to determine whether expenses were allowable, allocable and reasonable; and (7) reviewed the status of actions taken by HealthNow in response to the OIG's October 2002 audit report "Review of Selected Aspects of HealthNow NY-Upstate Medicare Division's Operations for Fiscal Year 2000" (CIN: A-02-01-01019). We reviewed the status of findings in this prior audit report since the audit covered fiscal year (FY) 2000, which was part of our audit period. Where recommended adjustments identified in our prior report were not made to the FY 2000 FACP, we restated the findings within this report.

Our audit was conducted in accordance with generally accepted government auditing standards. Fieldwork, which included visits to HealthNow's office in Buffalo, New York, was performed during the period February 2003 through July 2003.

## **FINDINGS AND RECOMMENDATIONS**

We determined that HealthNow generally had established adequate systems for internal control, accounting and reporting for administrative costs. In addition, nothing came to our attention to indicate any material control weaknesses. Further, the administrative costs claimed on the FACP for the period October 1, 1999 through September 30, 2002, were generally in accordance with Part 31 of the FAR and Appendix B of HealthNow's

Medicare agreement with CMS. However, our review disclosed that \$317,593 of the costs claimed on the FACP for our audit period were overstated. The results of our review are summarized in Exhibits A and B and discussed in detail below:

### **Complementary Credits**

HealthNow understated the complementary insurance credits claimed on the FY 2001 and FY 2002 FACPs by \$143,359. Section 4601 of the Medicare Carrier's Manual states that Medicare Carriers "may release Medicare claims information for complementary insurance purposes. "Where a complementary insurer routinely desires to have Medicare claims information," the Carrier should "charge the costs of releasing claims information to outside organizations to the Medicare program, and credit income to the program." Section 4601 B requires the Carrier, "...on an annual basis, to report the detail of these credits on the credit schedule report of Form HCFA 1524 (FACP)."

In computing the complementary credits to Medicare on the FY 2001 and 2002 FACPs, HealthNow, due to an oversight, excluded claims processed under the company's former name (Blue Cross and Blue Shield of Western New York - BCBS WNY). As a result, administrative costs claimed on the FY 2001 and FY 2002 FACPs were overstated by \$143,359 (\$52,600 for FY 2001 and \$90,759 for FY 2002).

### **Recommendation**

We recommend that HealthNow reduce the FY 2001 FACP by \$52,600 and the FY 2002 FACP by \$90,759 (total of \$143,359) based on the understated complementary credits.

### **HealthNow's Comments**

HealthNow officials concurred with our recommendation.

### **Notice of Budget Approval**

Medicare Integrity Program costs included in the FY 2000 FACP exceeded the Notice of Budget Approval (NOBA) by \$128,976. Section I Article XVI (C) of CMS's Part B contract limits actual costs to the annual amount on the NOBA. In addition, Section I Article XVI (D) of the Medicare contract indicates that actual costs for individual line items may not exceed five percent of the largest approved amount for that line item without prior written approval of the Secretary. The Medicare contract further stipulates that the Carrier is to submit Supplemental Budget Requests (SBRs) when accrued expenditures are expected to exceed the original approved prospective budget amounts.

In the latest FACP for FY 2000 (FACP No. 5), HealthNow claimed Medicare Integrity Program costs in excess of the latest NOBA (No. 17) by \$128,976. In addition, the \$128,976 included \$39,103 of costs, which exceeded the five percent limit for individual line items in the budget (See EXHIBIT C for details).



We also addressed this finding in a prior audit report entitled, "Review of Selected Aspects of HealthNow NY-Upstate Medicare Division's Operations for Fiscal Year 2000" (CIN: A-02-01-01019). The amount exceeding the NOBA, as indicated in the prior audit, totaled \$132,249. We determined that HealthNow had not obtained prior approval from CMS for the excess costs and did not have procedures to monitor costs in excess of budget limits. HealthNow subsequently issued an adjusted FACP (No. 5) for FY 2000, in which the amount exceeding the NOBA decreased from \$132,249 to \$128,976.

HealthNow officials acknowledged that the FY 2000 FACP exceeded the NOBA by \$128,976. However, a Supplemental Budget Request for the budget increase was never submitted to CMS.

### **Recommendation**

We recommend that HealthNow reduce the FY 2000 FACP by \$128,976 for costs claimed in excess of the NOBA. We further recommend that HealthNow monitor costs claimed on the FACP, so as not to exceed NOBA limits.

### **HealthNow's Comments**

HealthNow officials concurred with our finding and agreed to resubmit the FACP if directed by CMS.

### **Executive Compensation**

HealthNow claimed \$42,075 of unallowable executive compensation increases on the FY 2000 through FY 2002 FACPs. Federal regulations (Section 31.205-6 (b) of the FAR) require that compensation charged to Medicare be reasonable. The increases for a number of executive salaries reviewed, exceeded the average rate of change in employee compensation as measured by the U.S. Department of Labor, Bureau of Labor Statistics' Employment Cost Index (ECI), and therefore, were considered unreasonable.

We used the ECI for executive compensation because we consider it to be the most equitable and relevant measure. The ECI represents dozens of indices that are calculated for various occupational and industry groups to measure the rate of change in employee compensation. Further, the ECI is distinguished from other employee compensation surveys in that it covers all establishments and occupations in both the private and public sectors.

For employees in executive administrative and managerial occupations, the ECI showed a 4.2% average salary increase for years 2000 and 2001, and a 3.3% average salary increase for year 2002. We analyzed the salary increases for all employees at the level of vice-president and above whose salaries were allocated to Medicare. For the 12 executives included in our analysis, four received salary increases greater than the ECI in

years 2000 and 2001, and eight received salary increases above the ECI in 2002. This equated to \$42,075 of excess executive compensation claimed on the FACP.

HealthNow has disagreed with our use of the ECI as a measure of reasonableness of executive salary increases.

### **Recommendation**

We recommend that HealthNow reduce the FY 2000 FACP by \$1,802, the FY 2001 FACP by \$6,623 and the FY 2002 FACP by \$33,650 (total of \$42,075), based on excess executive compensation claimed.

### **HealthNow's Comments**

HealthNow did not agree with our use of the ECI as the sole means for determining salary increases and in being a representative measure for monetary comparisons. In addition, HealthNow indicated that two of the four individuals whose salary we found excessive, should not have been part of the executive compensation finding. For both these individuals, HealthNow argued that the increases in compensation were justified because of dramatic increases in their responsibilities.

### **OAS Response**

We continue to maintain that use of the ECI is an equitable and relevant measure in determining reasonableness of increases in executive compensation. Although the FAR does not specifically cite the ECI as a sole measurement of salary increases, it also does not prohibit its use as a measurement tool.

Regarding the two individuals HealthNow felt we should have excluded from our review, we did in fact exclude salary increases received in the effective year of their promotion. However, we properly included those two individuals for the years prior to and/or subsequent to the promotional year because the salary increases far exceeded the 4.2 percent ECI average. In that regard, for calendar year 2000, despite not receiving a promotion until December 30, 2000, the salary of one of the individuals increased 12.53 percent. In 2001, that same employee's salary increased 14.97 percent. We did not question the 2001 increase since it occurred in the effective year of the promotion. However, in calendar year 2002 the employee's salary increased another 15.83 percent. Regarding the other individual, the employee also received a promotion on December 30, 2000. In 2001, although the employee's salary increased 33.43 percent, we did not question the increase since it pertained to the effective year of the promotion. However, for calendar year 2002, the individual received another salary increase of 34.84 percent. The large salary increase percentages, aside from those due to promotions, seem to show a consistent pattern, of excessive increases, which appear unreasonable. We therefore maintain our recommendation that, HealthNow reduce the FY 2000 FACP by \$1,802, the FY 2001 FACP by \$6,623 and the FY 2002 FACP by \$33,650 (total of \$42,075) resulting from the excess executive compensation claimed.

## **EDP Depreciation**

HealthNow expensed rather than depreciated \$2,099 of computer software and allocated \$1,494<sup>1</sup> of this amount to Medicare on the FY 2002 FACP. The \$2,099 is comprised of two software items purchased on September 20, 2000, each having unit prices exceeding \$500 (\$849 and \$1,250).

The Part B Medicare contract Appendix B Section IV (A) states:

*“All contractors must depreciate all items of equipment having a useful life of more than 1 year. The cost of equipment may not be charged off as an expense in the year of purchase. However, the contractor may expense minor items of equipment up to the unit cost of \$500 per item.”*

HealthNow expensed the software items over \$500 because the company's General Accounting Standard Operating Procedures (SOP) Number 1, revised October 2001, indicates that operational or application software costing less than \$10,000 is to be expensed as a period cost.

Since HealthNow policy is not in compliance with the Medicare contract, the \$1,494<sup>1</sup> allocated to Medicare on the FY 2002 FACP is unallowable.

## **Recommendation**

We recommend that HealthNow reduce its FY 2002 FACP by \$1,494 and depreciate the cost of the software in subsequent years. Additionally, HealthNow should revise its SOP for depreciation of software charged to Medicare to comply with requirements of its Medicare contract.

## **HealthNow's Comments**

HealthNow disagreed with the EDP depreciation finding of \$1,494. While they acknowledged that Part B Section IV (A) of the Medicare contract and the FAR 31.205-11 (a) allows for the depreciation of tangible capital assets, they felt that software is not a tangible piece of equipment. As a result, software would be subject to their own policies and procedures in which such items would be depreciated only if over \$10,000.

## **OAS Response**

While HealthNow did refer to the FAR 31.205-11 (a), they did not refer to the latter paragraphs of that section under (d), (e) and (f), which indicate that contractors must comply with policies and procedures acceptable for Federal income tax purposes. Under Title 26 USC section 167 (f) of the tax code, computer software is considered a

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<sup>1</sup> Since the computer software was purchased at the end of the FY 2002 (9/20/02), and was not placed into service until the beginning of the next fiscal year, we did not compute any depreciation for FY 2002.

depreciable asset and the amount of allowable depreciation must be computed using the straight line method with a useful life of 36 months.

We therefore continue to recommend that HealthNow exclude \$1,494 from its FY 2002 FACP and depreciate the cost of the software in accordance with the Medicare contract.

### **Public Relations and Advertising Costs**

HealthNow included \$1,689 of unallowable public relations and advertising costs allocated to Medicare on the FY 2000 FACP. The \$1,689 of expenses were for jackets worn by its employees during a “heartwalk.” The Federal Acquisition Regulations (FAR) 31.205-1(f) states that unallowable public relations and advertising costs include among others, all public relations and advertising costs whose primary purpose is to promote the sale of products or services by stimulating interest in a product or product line. Therefore, we determined the \$1,689 reported by HealthNow to be unallowable. This finding was previously reported in our prior audit report, CIN: A-02-01-01019.

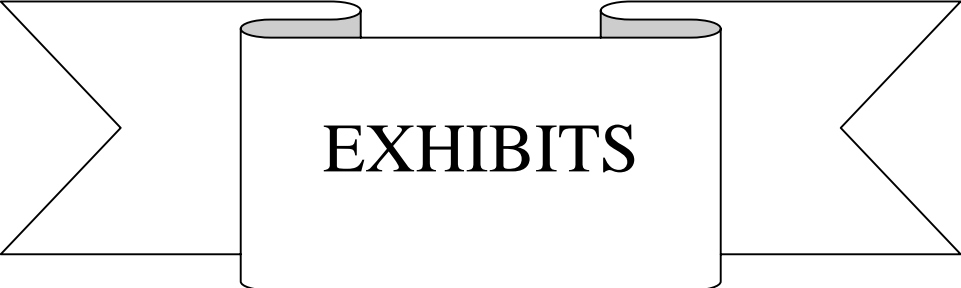
HealthNow officials initially classified these jackets as potentially unallowable on its accounting records and planned to make an adjusting entry to remove the costs from the FACP. However, due to a clerical oversight, the adjusting entry was not made.

### **Recommendation**

We recommend that HealthNow reduce the FY 2000 FACP by \$1,689 accordingly.

### **HealthNow’s Comments**

HealthNow officials concurred with our finding and agreed to resubmit the FACP upon direction from CMS.



**EXHIBIT A**

**HealthNow New York, Inc.**  
**Final Administrative Cost Proposal**  
**October 1, 1999 through September 30, 2002**

<u>Operation</u>	<u>FY 2000 Total Claimed</u>	<u>FY 2001 Total Claimed</u>	<u>FY 2002 Total Claimed</u>	<u>Total Claimed</u>
Bills/Claims Payment	\$13,057,743	\$12,696,503	\$14,162,234	\$39,916,480
Appeals/Reviews	1,787,163	2,064,174	1,609,136	5,460,473
Inquiries	3,717,741	1,830,024	1,953,767	7,501,532
Provider Education and Training	510,600	648,214	650,903	1,809,717
Participating Physician Reimbursement	78,828	56,810	63,665	199,303
Productivity Investment	-	-	-	-
Program Management Special Projects	-	88,586	73,596	162,182
Provider Telephone Inquiries	-	-	-	-
Medical Review	1,354,414	1,354,414	1,655,290	3,009,704
Medical Review	2,153,209	2,016,095	1,614,941	5,784,245
Medicare Secondary Payer	1,719,134	1,620,622	1,428,732	4,768,488
Benefits Integrity	907,943	1,034,587	1,146,645	3,089,175
MIP Provider Education	272,090	276,801	310,305	859,196
Audit	-	-	-	-
Productivity Investment	-	-	15,625	15,625
MIP Special Projects	-	-	-	-
Credits	-2,471,527	-2,619,681	-2,865,541	-7,956,749
Total Claimed Cost	<u>\$21,732,924</u>	<u>\$21,067,149</u>	<u>\$21,819,298</u>	<u>\$64,619,371</u>
Costs Not Reviewed:				
Pension Costs	-\$1,118,759	-\$866,567	-\$942,486	-\$2,927,812
Total Claimed Cost Subject To Review	<u>\$20,614,165</u>	<u>\$20,200,582</u>	<u>\$20,876,812</u>	<u>\$61,691,559</u>
Total Recommended Adjustments (Exhibit B)	<u>-132,467</u>	<u>-59,223</u>	<u>-125,903</u>	<u>-317,593</u>
Balance After Recommended Audit Adjustments	<u><u>\$20,481,698</u></u>	<u><u>\$20,141,359</u></u>	<u><u>\$20,750,909</u></u>	<u><u>\$61,373,966</u></u>

**EXHIBIT B**

**HealthNow New York, Inc.**  
**Schedule of Recommended Adjustments**  
**October 1, 1999 through September 30, 2002**

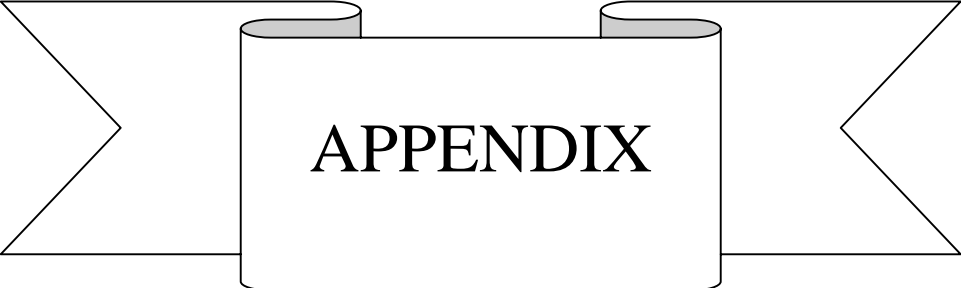
<b><u>Classification</u></b>	<b><u>FY 2000</u></b>	<b><u>FY 2001</u></b>	<b><u>FY 2002</u></b>	<b><u>Total</u></b>
Salaries and Wages	\$1,802	\$6,623	\$33,650	\$42,075
EDP Equipment	-	-	1,494	\$1,494
Miscellaneous	1,689	-	-	\$1,689
Complementary Credits	-	52,600	90,759	\$143,359
Excess over NOBA	128,976	-	-	\$128,976
Total Recommended Adjustments	<u>\$132,467</u>	<u>\$59,223</u>	<u>\$125,903</u>	<u>\$317,593</u>

## EXHIBIT C

**HealthNow New York, Inc.**  
**Comparison of Final NOBA to FACP**  
**For MIP Funding**  
**FY 2000**

ACTIVITY CODE	DESCRIPTION	NOBA # 17	FACP # 5	DIFFERENCE		AMOUNT OVER 5%
				AMOUNT	%	
<b><u>MIP FUNDING</u></b>						
21000	Medical Review (MR)	\$2,190,900	\$2,153,209	-\$37,691	-1.72%	\$0
22000	Medicare Secondary Payor	1,645,900	1,719,134	73,234	4.45%	0
23000	Benefits Integrity	845,400	907,943	62,543	7.40%	20,273
24000	MIP Prov Educ & Training	241,200	272,090	30,890	12.81%	18,830
<b>TOTAL</b>		<b>\$4,923,400</b>	<b>\$5,052,376</b>	<b>\$128,976</b>	<b>2.62%</b>	<b>\$39,103</b>





**APPENDIX**



## Medicare

Part B Carrier &  
Durable Medical Equipment Regional Carrier  
716-887-6922

October 6, 2003

Mr. Timothy J. Horgan  
Regional Inspector General, Office of Audit Services  
Region II  
Jacob K. Javits Federal Building  
26 Federal Plaza  
New York, NY 10278

Re: Common Identification Number: A-02-03-01012

Dear Mr. Horgan:

This letter is in response to the U.S. Department of Health & Human Services, Office of Inspector General, Office of Audit Services' draft report entitled "REVIEW OF MEDICARE PART B ADMINISTRATIVE COST CLAIMED BY HEALTHNOW NEW YORK, INC. FOR THE PERIOD OCTOBER 1, 1999 THROUGH SEPTEMBER 30, 2002." HealthNow has reviewed the draft report. Following are comments regarding the specific findings.

### FY 2000 – FY 2002 FACP Findings/Recommendations:

#### Complementary Credits:

HealthNow agrees that the FY 2001 and FY 2002 FACPs were overstated by \$52,600 and \$90,759 respectively due to the fact that complementary credits were not invoiced to Blue Cross & Blue Shield of Western New York due to a clerical misunderstanding.

#### Costs Exceeding the NOBA:

HealthNow agrees that the MIP cost exceeded the NOBA by \$128,976. This was noted in HealthNow's CPE for FY 2000, a Performance Improvement Plan (PIP) was submitted December 1, 2000 and closed February 13, 2001.

The OIG recommendation is to reduce the FACP. HealthNow submitted the FACP at the cost to administer the program and was not reimbursed for this expense. HealthNow will not resubmit the FACP until directed to by CMS during the final settlement.

#### Executive Compensation:

HealthNow does not agree with using the Department of Labor, Employment Cost Index (ECI) as the sole means for determining salary increases. The FAR does not identify the ECI as the sole basis for determining the reasonableness of compensation. FAR 31.201-3(a) provides that "[a] cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business." FAR 31.201-3(b) states that reasonableness "depends upon a variety of considerations and circumstances" including costs recognized as ordinary and necessary for the conduct of the contractor's business, generally accepted sound business practices, the contractor's responsibilities to others, including the government, and any significant deviations from the contractor's established practices. FAR 31.205-6(b) shows the many elements that can be relevant for purposes of determining the reasonableness of overall compensation. The FAR confirms the unfairness of the OIG's approach of using the ECI as the sole measuring rod for compensation reasonableness.

**HealthNow**  
HealthNow New York Inc.

Upstate Medicare Division & DMERC A  
Divisions of HealthNow New York Inc.

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CMS Contracted Carrier

Among the factors should be taken into account in recognizing that our executive salary increases were not out of line is that the FAR says that monetary comparisons should be between common entities, *e.g.*, companies “of the same size,” companies “in the same industry,” and companies “in the same geographic area.” By the OIG’s own admission, in this audit report the ECI is calculated for “various occupational and industry groups.”

Thus, the ECI is not measuring the national salary increases of Medicare contractors or of insurance companies in New York or even in the Northeast corridor. Instead, the ECI considers all establishments and occupations in the economy. And it is an average in any event, not a ceiling. While the ECI may well be interesting and useful measure for certain national economic indices, it is not a tool that the FAR, the caselaw, nor the Medicare contract requires to be used as the one and only way to establish the reasonableness of executive salary increases. Even when the government determines the executive compensation level each year the ECI is not used. The executive compensation is determined by using the median amount of the compensation provided for all senior executives of all benchmark corporations for the most recent year for which data is available. It is based on a review of commercially available surveys of executive compensation.

HealthNow provided the audit team with documentation supporting the executive salary increases. An independent outside consulting firm reviews our salary structure and provides a competitive analysis for executives in HealthNow’s peer group.

That being said, following are two individuals who HealthNow believes should not be part of the executive compensation finding:

**1. Comparison between 1999 and 2000**

There are four individuals cited for exceeding the ECI. One individual responsibility increased dramatically in 2000. He was not only responsible for the UMD operation but transitioned the DMERC contract to HealthNow. This equates to \$1,296 of the \$1,802 for 2000.

**2. Comparison between 2001 and 2002**

There are seven individuals cited for exceeding the ECI. One individual was promoted in December 31, 2000 yet her salary did not reflect the dramatic increase in responsibility until 2002. Her salary is significantly less than the individual she replaced and is not consistent with other Vice Presidents. The consultant report points out this discrepancy. The amount in question is \$19,450 of the \$33,650 for 2002.

HealthNow is willing to agree to disagree with using the ECI as the sole measure for salary adjustments. Although, HealthNow takes exception to \$20,746 of the \$42,075 total finding.

EDP Depreciation:

HealthNow does not agree with the EDP depreciation finding of \$1,494. We agree with the OIG that the Part B Medicare contract Appendix B Section IV (A) refers to depreciating all items of equipment with a useful life of more than one year but software is not a tangible piece of equipment. Per FAR 31.205-11:

“Depreciation is a charge to current operations which distributes the cost of a tangible capital asset...”

HealthNow believes depreciation should be consistent with the policies and procedures used in like cost centers for businesses other than government. HealthNow’s policies and procedures depreciate tangible assets of \$500 or more with a useful life over one year but since software is not tangible the criteria in the policies and procedures is \$10,000.

HealthNow believes the EDP depreciation cited in the finding is an allowable expense.

Public Relations and Advertising Cost:

HealthNow agrees that we submitted the FY 2000 FACP with \$1,689 in unallowable cost due to clerical oversight. HealthNow is willing to make manual entries and re-submit the FACP upon direction from CMS or address the unallowable cost during the settlement agreement.

HealthNow would like to thank the audit team for their professionalism and recognition of the ongoing operation during the audit.

If you have any questions please contact me.

Sincerely,



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

CC: D. Przybysz (HealthNow)  
W. Wickis (HealthNow)