DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date JUN 30 1994

From June Gibbs Brown
Inspector General

Subject The Health Care Financing Administration's Implementation of the Federal Managers' Financial Integrity Act for Fiscal Year 1993 (A-14-93-03026)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

This final report provides you with the results of our review of the Health Care Financing Administration's (HCFA) implementation of the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year (FY) 1993. The overall objective of our review was to determine whether the FMFIA program is adequate to provide reasonable assurance that management controls and financial management systems detect fraud, waste, and mismanagement.

To achieve our objective, we reviewed HCFA's segmentation process used to develop its management control plan (MCP). This review included the coverage of Medicare contractors. We also evaluated HCFA's management controls, financial management systems, and corrective action reviews, and we analyzed the status of pending high-risk areas and material weaknesses.

The HCFA provides oversight of program and administrative functions through implementation of its FMFIA program. In accordance with the Department of Health and Human Services' (HHS) policy, HCFA segments its operations into management control areas (MCA). Each MCA is assessed for the relative risk to fraud, waste, and mismanagement. As part of this process, HCFA develops a 5-year plan to systematically evaluate MCAs to identify and correct weaknesses.

We have reviewed HCFA's segmentation process, its risk assessment of MCAs, and corrective actions of weaknesses previously identified. The HCFA's management has continued to emphasis the importance of effective management controls to achieve programmatic and management objectives. There is a continuing effort within HCFA to improve the process, and we applaud its efforts to establish effective controls.

weaknesses or Office of Management and Budget high-risk designation as a high risk, expand financial management system reviews, reestablish the cost allocation system material weakness until all components have properly implemented the system, perform corrective action reviews on all corrected material weaknesses, and reevaluate the corrective action plan for the Medicare secondary payer high-risk area.

In response to our draft report, HCFA disagreed with some of our recommendations. However, after reviewing HCFA's comments and having follow-up meetings with HCFA officials, we modified our recommendations to include HCFA's concerns. Although HCFA did not agree with the specifics of our recommendation that HCFA modify its plan that covers the Medicare contractors' management controls and financial management systems to ensure that it has adequate coverage of the contractors under FMFIA, it concurred with the intent. The HCFA is taking an alternative approach to address the concerns of the coverage of the contractors' controls. Although we continue to recommend a different approach to address the contractors' controls, we will work with HCFA in this area to reach concurrence on an acceptable approach.

Please advise us within the next 60 days on actions taken or planned on our recommendations. If you have any questions, please call me or your staff may contact George M. Reeb, Assistant Inspector General for Health Care Financing Audits, at (410) 966-7104. Copies of this report are being sent to other interested Department officials.

To facilitate identification, please refer to Common Identification Number A-14-93-03026 in all correspondence relating to this report.

Attachments

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

THE HEALTH CARE FINANCING ADMINISTRATION'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT FOR FISCAL YEAR 1993

JUNE GIBBS BROWN
Inspector General

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To

Bruce C. Vladeck
Administrator
Health Care Financing Administration

Attached are two copies of our final audit report entitled, *The Health Care Financing Administration's Implementation of the Federal Managers' Financial Integrity Act for Fiscal Year 1993*. The overall objective of our review of the Health Care Financing Administration's (HCFA) Federal Managers' Financial Integrity Act (FMFIA) program is to determine whether the program is adequate to provide reasonable assurance that management controls and financial management systems detect fraud, waste, and mismanagement. We recognize that the Office of Management and Budget is revaluating the FMFIA and modifying its requirements to streamline the overall process. However, this report addresses HCFA's Fiscal Year 1993 FMFIA program.

The HCFA's management has continued to emphasize the importance of effective management controls to achieve programmatic and management goals and objectives. There is a continuing effort within HCFA to improve the process, and we applaud its efforts to establish effective controls.

Based on our review of HCFA's Fiscal Year 1993 implementation of FMFIA, we continue to have concerns on the coverage of management controls and financial management systems at Medicare contractors. Because of the significant role contractors play in HCFA's operations, we were unable to determine with reasonable assurance that coverage of management controls and financial management systems was adequate.

We recommend that HCFA modify its plan that covers the Medicare contractors' management controls and financial management systems to ensure that it has adequate coverage of the contractors under FMFIA. We also recommend that HCFA review the functions of the Office of the Actuary, reclassify all management control areas with pending material

In our prior reviews of HCFA's FMFIA program, we have commented on the need to include the program and management functions of Medicare contractors under the FMFIA program. In FY 1993, concurrent with our review of HCFA's FMFIA program, we have been conducting an audit of HCFA's financial statements in accordance with the Chief Financial Officers' (CFO) Act. As part of this audit, we evaluated the internal control structures at selected Medicare contractors. Our assessment is that the risk is high that the internal controls over the accounts receivable at Medicare carriers and fiscal intermediaries (FI), and over the accounts payable at FIs are unlikely to be effective in preventing or detecting material losses, noncompliances, or misstatements on a timely basis.

In FY 1993, for the first time, HCFA developed a plan as part of their FMFIA program to cover the management controls and financial management systems of Medicare contractors. This process identified over 5,200 alternative management control reviews (AMCR) which test controls and are performed at contractors. Based on this approach, HCFA believes that the management controls of contractors are adequately covered.

We reviewed HCFA's plan to evaluate whether coverage is adequate. We concluded that the plan does not identify the control procedures which contractors have implemented to provide reasonable assurance that specific control objectives as outlined as part of an FMFIA program are achieved. Therefore, there is no assessment by HCFA of the control risks to determine whether transactions are properly authorized; functions are segregated; proper safeguards are in place; or independent checks are performed. Also, prior Office of Inspector General (OIG) and General Accounting Office (GAO) reports have identified control weaknesses that were not discovered by HCFA's contractor reviews.

We bring to your attention two other unresolved issues, which in addition to the coverage of Medicare contractors, were discussed in our FY 1992 report but HCFA has not fully implemented corrective actions. First, the activities of the Office of the Actuary (OACT) which are used to derive financial statement balances are not covered in the management control plan; and second, the Common Working File (CWF) and Medicare contractors' claims processing systems should be reviewed as part of the requirements of the Office of Management and Budget (OMB) Circular A-127.

Based on our review of HCFA's implementation of FMFIA, we continue to have concerns on the coverage of management controls and financial

management systems at Medicare contractors. Because of the significant role contractors play in HCFA's operations, we were unable to determine with reasonable assurance that coverage of management controls and financial management systems was adequate.

We recommend that HCFA modify its plan that covers the Medicare contractors' management controls and financial management systems to ensure that it has adequate coverage of the contractors under FMFIA. We also recommend that HCFA review the functions of the OACT, reclassify all MCAs with pending material weaknesses or OMB high-risk designation as a high risk, expand financial management system reviews, reestablish the cost allocation system material weakness until all components have properly implemented the system, perform corrective action reviews (CARs) on all corrected material weaknesses, and reevaluate the corrective action plan for the Medicare secondary payer (MSP) high-risk area.

In response to our draft report, HCFA disagreed with a few of our recommendations. However, after reviewing HCFA's comments and having follow-up meetings with HCFA officials, we modified our recommendations to include HCFA's concerns. Although HCFA did not agree with the specifics of our recommendation that HCFA modify its plan that covers the Medicare contractors' management controls and financial management systems to ensure that it has adequate coverage of the contractors under FMFIA, it concurred with the intent. The HCFA is taking an alternative approach to address the concerns of the coverage of the contractors' controls. Although we continue to recommend a different approach to address the contractors' controls, we will work with HCFA in this area to reach concurrence on an acceptable approach.

BACKGROUND

The purpose of the FMFIA is to ensure that the management and administrative controls of each executive agency are established in accordance with standards prescribed by the Comptroller General, and provide reasonable assurance that obligations and costs are in compliance with applicable law; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports; and to maintain accountability over assets.

The FMFIA requires each executive agency, on the basis of an evaluation conducted in accordance with guidelines prescribed by OMB, to prepare a statement each year that certifies whether or not the agency's management controls and financial management systems comply with the requirements of the FMFIA and OMB circulars.

The OMB circulars provide detailed guidance for evaluating, improving, and reporting on management controls and financial management systems. The OMB Circular A-123, *Internal Control Systems*, prescribes policies and standards for executive departments to implement section 2 of the FMFIA by establishing, maintaining, testing, improving, and reporting on management controls in their programmatic and administrative activities. Each agency is required to report any material weaknesses in the agency's systems of management controls and the planned corrective actions. The OMB Circular A-127, *Financial Management Systems*, provides the policies and procedures for executive departments to implement section 4 of the FMFIA by developing, operating, testing, and reporting on financial management systems. This Circular also prescribes that financial management systems should record and report data that facilitates carrying out the responsibilities of both program and administrative managers.

The HCFA's FMFIA program consisted of six critical elements: segmentation, risk assessment, management control reviews, financial management system reviews, CARs, and identification and correction of management control weaknesses. As part of this process, HCFA develops a 5-year plan to systematically evaluate MCAs to identify and correct weaknesses.

In FY 1993, HCFA for the first time developed a plan as part of their FMFIA program to cover the management controls and financial management systems of Medicare contractors. Their process identified over 5,200 AMCRs which are performed at contractors and tested controls. Based on this approach, HCFA believes that the management controls of contractors are adequately covered.

For FY 1993, HCFA reported to the Secretary of HHS that its management controls and financial management systems, as a whole, provided reasonable assurance that the objectives of the FMFIA had been achieved. In addition, it reported 10 material weaknesses and high-risk areas for

FY 1993. Although HCFA identified two of these material weaknesses through its FMFIA process, they were not related to the Medicare contractors' functions.

SCOPE

The overall objective of our review of HCFA's FY 1993 FMFIA program was to evaluate whether HCFA's FMFIA program provides reasonable assurance that management controls and financial management systems are adequate to detect fraud, waste, and mismanagement.

To achieve our objective, we reviewed HCFA's segmentation process used to develop its MCP, including coverage of Medicare contractors, management control reviews (MCR), financial management system reviews, and status of high-risk areas and material weaknesses.

Our review of HCFA's segmentation process included analyzing FY 1993 plan revisions and determining prior year actions taken on OIG recommendations.

In addition, we reviewed

- one of the 18 completed MCRs,
- corrective action review process,
- HCFA's cost allocation system corrective actions,
- pending high risks and material weaknesses,
- HCFA's inventory and review process of financial management systems pursuant to OMB Circular A-127,
- prior year OIG recommendations, and
- internal control assessments[1] pertaining to selected Medicare contractors generated from our CFO Act audit of the HCFA FY 1993 financial statements.

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[1] Our internal control assessments at selected Medicare contractors were conducted from June 1993 to August 1993.

Our review was made in accordance with generally accepted government auditing standards. Our field work was performed at HCFA's central office during the period March 1993 through September 1993.

RESULTS OF AUDIT

MANAGEMENT CONTROL SYSTEMS

Our review of HCFA's implementation of management control systems as required by OMB Circular A-123 consisted of evaluating segmentation, coverage of Medicare contractors, MCRs, CARs, and high-risk areas and material weaknesses.

SEGMENTATION

Segmentation is the process of dividing an organization into meaningful and discrete areas that allow for efficient evaluation of management controls. During FY 1993, HCFA analyzed and updated its inventory of MCAs. Also, HCFA for the first time identified AMCRs which are performed at contractors. The MCP covering the period FY 1994 through 1998 includes 81 MCAs and over 5,200 AMCRs.

In our prior reports on HCFA's FMFIA program, we stated that too much emphasis was placed on identifying and reviewing administrative areas and not enough on high-dollar program areas. The HCFA has made improvements by deleting 14 MCAs, adding 12 new MCAs, and including the management controls and financial management systems of Medicare contractors into its plans.

The revisions, however, do not fully address all of HCFA's critical activities. For example, coverage of the Medicare contractors is incomplete and major programmatic areas of certain components, such as the OACT, were not covered.

Medicare Contractors

In our FY 1992 FMFIA report, we recommended that HCFA develop a review methodology that actually tests the management controls at the contractors so that HCFA could have reasonable assurance that controls are adequate. The HCFA has developed a plan to cover the contractors by reviewing five functional areas: claims processing, audit and reimbursement, service, benefits integrity, and pre- and post-payment activities. Each of these functions are further broken down into objectives, risks, controls, and tests. The HCFA has identified over 5,200 AMCRs which are performed at contractors and test management controls and financial management systems. These AMCRs include HCFA quality assurance programs and OIG reports. The HCFA matched these AMCRs to the program objectives as a

means to satisfy FMFIA requirements. Based on this approach, HCFA believes that these management controls and financial management systems at contractors are adequately covered.

We believe that these AMCRs can be used as a mechanism to satisfy FMFIA requirements. However, we continue to have concerns on the coverage of management controls and financial management systems at Medicare contractors. The plan does not identify the control procedures which contractors have implemented to provide reasonable assurance that specific control objectives are achieved. Therefore, there is no assessment by HCFA of the control risk to determine whether transactions are properly authorized, functions are segregated, proper safeguards are in place, or independent checks are performed. The plan also does not identify which control procedures the 5,200 AMCRs actually test.

Accounts Receivable and Payable Weaknesses

Our reviews of the controls over the processing and reporting of accounts receivable and accounts payable during FY 1993 have shown that problems continue in these contractor functions. As part of our audit of HCFA's financial statements, in accordance with the CFO Act, we reviewed the internal control structures relating to contractors' accounts receivable, accounts payable, and benefit payments. We concluded[2] that the risk is high that the internal controls over the accounts receivable at Medicare carriers and FIs, and over the reporting of accounts payable at FIs are unlikely to be effective in preventing or detecting material losses, noncompliances, or misstatements on a timely basis.

We believe that HCFA would have detected these weaknesses had MCRs in these areas been performed. The AMCRs identified by HCFA do not appear to address these functions. We have previously reported weaknesses in the contractors' internal control structures over the processing and reporting of accounts receivable at September 30, 1991.[3] We included recommendations that HCFA perform FMFIA section 4 reviews on all financial management systems used to report accounts receivable and report the lack of financial management systems to properly record, monitor, follow up, and collect overpayments as a material nonconformance under the

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[2] A summary of weaknesses we found during our FY 1993 review of the contractors' accounts receivable and accounts payable functions can be found in the Appendix I.

[3] OIG final report entitled *Review of the Accounts Receivable Balances for the Hospital Insurance and Supplementary Medical Insurance Trust Funds at September 30, 1991,* (A-01-91-00525, dated June 1993).

FMFIA. The HCFA responded that it has scheduled, beginning with FY 1993, joint FMFIA section 2/4 integrated reviews[4] for its financial management systems and has deferred comment with regard to the declaration of the material nonconformance issue.

We also identified, in one final and two draft reports, weaknesses in the contractors internal control structures over the processing and reporting of accounts payable and accounts receivable at September 30, 1992.[5] For both accounts payable and receivable, we reported that HCFA needs to strengthen its internal control structures to ensure that transactions are properly processed and reported in order to be in compliance with the CFO Act and the FMFIA. All three reports reiterated our belief that the weaknesses found could have been identified if MCRs were conducted in accordance with OMB requirements.

Quality Assurance Programs Addressing Financial Reporting Control Objectives

Financial reporting controls are designed to prevent or detect aggregate misstatements in significant financial statement assertions. During our reviews of HCFA's internal control structures over the processing and reporting of accounts payable and accounts receivable at September 30, 1992, we identified 14 various contractor monitoring programs HCFA used during FY 1992 to evaluate contractor management controls.

We reported that for FI accounts payable functions only 4 of the 7 monitoring programs addressed 3 of the 10 transaction-related financial reporting control objectives. In addition, for carrier accounts payable functions, only 3 of the 7 monitoring programs addressed 3 of the 10 transaction-related financial reporting control objectives. However, for FI and carrier accounts receivable none of the monitoring programs activities evaluated financial reporting control objectives.

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[4] A section 2/4 integrated review combines a FMFIA section 2 review of a management control system and a FMFIA section 4 review of a financial management system.

[5] OIG draft reports entitled, *Review of the Internal Control Structure Over the Accounts Payable Balance for the Supplementary Medical Insurance Trust Fund at September 30, 1992,* (A-04-92-02054, dated September 1993) and Review of the Internal Control Structure Over the Accounts Payable Balance for the Hospital Insurance Trust Fund at September 30, 1992, (A-05-92-00106, dated September 1993). And, OIG final report entitled, *Review of the Accounts Receivable Balances for the Hospital Insurance and Supplementary Medical Insurance Trust Funds at September 30, 1992,* (A-01-92-00516, dated March 14, 1994).

We do not believe the contractor monitoring programs adequately test accounts payable and accounts receivable transactions or are an adequate substitute for management control and financial management system reviews required under the FMFIA. We are unable to conclude with reasonable assurance whether the contractor monitoring programs could identify problems and weaknesses in financial reporting controls applicable to accounts payable and accounts receivable.

Our analysis of HCFA's AMCRs used to monitor the contractors' FY 1993 functions disclosed that financial data is not adequately tested nor can it be determined that these reviews are an adequate substitute for management control and financial management system reviews required under FMFIA. Our analysis shows that 18 of the 22 AMCR areas addressed, to a limited extent, the financial reporting control objectives.[6] The AMCRs cover some objectives relating to FI's and carrier's accounts receivable, accounts payable, and benefit payments. However, none of the AMCRs follow the flow of transactions back to their initial point of entry into the system. Additionally, the AMCRs do not address control procedures such as segregation of duties, design and use of documents and records, independent checks, or summarization of accounting data. This illustrates that important controls are not covered by these reviews of Medicare contractors.

As an illustration, the Intermediary System Testing Project (ISTP) tests the valuation of FI's accounts payable and benefit payments using a HCFA prepared dummy test deck of approximately 100 Part A bills. Our review showed that this test did not address any of the account related financial control objectives, but it did address five of the transaction-related financial reporting control objectives.[7] In addition, at one contractor we found that ISTP was not effectively implemented. In this instance, adequate instructions were not provided to the FI to completely process the test bills accurately. We believe that significant controls are not adequately tested through the use of dummy-test-deck procedures. Although the ISTP tests certain procedures over transaction control objectives, it did not test many of the essential control procedures, such as segregation of duties, design and use of documents and records, independent checks, or summarization of accounting data, that are necessary to ensure the control procedures

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[6] For a summary of the 22 AMCRs HCFA used to evaluate contractors during FY 1993 and our assessment of the financial reporting control objectives addressed, see Appendix II.

[7] Transaction-related control objectives follow a transaction from its initial point of entry into a system through summarization in a line item or account balance.

effectively address the financial reporting control objectives. Until reviews are conducted on the contractors' management control systems, we continue to have concerns on the coverage of management controls and financial management systems at Medicare contractors, and we are unable to determine with reasonable assurance that coverage of management controls and financial management systems is adequate.

Office of the Actuary (OACT)

In our FY 1992 FMFIA report, we recommended that HCFA incorporate the programmatic activities of the OACT into the MCP. The OACT's programmatic activities included preparing the Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund and the Annual Report of the Board of Trustees of the Supplementary Medical Insurance Trust Fund. These annual reports included a statement of assets and benefit payments for the prior year, an estimate of expected income and benefit payments during the current and the next 2 years, and the actuarial status of the trust funds.

In response to our prior report, HCFA stated that the functions of OACT, except for the personnel administrative functions, are a discretionary analytical process and not subject to the FMFIA program. However, since OACT uses data provided by other organizations, HCFA has agreed to include all components providing data in the MCP.

During our audit of HCFA's financial statements, we determined that the OACT also has functions which are used to derive the accounts payable balance for accrued benefits payable.

Because of the OACT involvement with financial statements, we continue to believe that it is imperative that OACT's management controls be reviewed pursuant to the FMFIA.

MANAGEMENT CONTROL REVIEWS (MCR)

An MCR is a detailed evaluation of an MCA to determine whether necessary controls are in place and producing the intended results. The results of an MCR must be adequately documented to support the conclusions rendered as a result of the review. Such documentation must be clear, concise, and readily available.

We reviewed 1 of the 15 completed MCRs to determine if the review covered all of the necessary control objectives and was adequately

documented. We found that HCFA's management control reviews of the CWF included all of the necessary functions.

Risk Assessment

The risk assessment analyzes the general control environment and assesses the inherent risk within the area to be reviewed. The HCFA updates the risk assessment that allows management to evaluate any recent changes that might effect the sensitivity of the activities within the area.

In our prior reports on HCFA's FMFIA program, we recommended that HCFA consider reclassifying its risk assessment of MCAs that are pending material weaknesses and high-risk areas to a high-risk rating. The MCP is still classifying some MCAs with a material weakness as a moderate risk. The MCAs with a low or moderate risk that contain a material weakness are as follows:

MCA	MATERIAL WEAKNESS
Medicare Claims Processing (FI)	Payments for Medically Unnecessary Services
Medicare Audit and Reimbursement	Indirect Medical Education
Grants/Cooperative Agreements Approvals	Grants Management
Compliance Activity	Paperwork Reduction Act
Medicaid Eligibility Quality Control	Medicaid Eligibility Quality Control

We expressed our concern over this practice in our FY 1992 FMFIA report, and we continue to have concerns that this practice is misleading and unjustifiable. But, the HCFA continues to believe that there are some circumstances where a moderate rating is more appropriate because all key management controls are in place and working as intended. We still believe, nevertheless, that a MCA with a material weakness or OMB high-risk designation should be classified as a high risk.

CORRECTIVE ACTION REVIEWS (CAR)

The purpose of an CAR is to verify and test corrective actions and provide reasonable assurance that material weaknesses and high risks have been

corrected. A CAR must be started for all material weaknesses and high-risk areas reported in the Secretary's annual FMFIA report within 1 year after material weaknesses and high-risk areas have been reported as corrected.

The HCFA reported that four material weaknesses were corrected during FY 1992. However, HCFA stated that only two weaknesses required a corrective action review since the other two weaknesses were compliance issues. We believe all material weaknesses and high-risk areas should be reviewed to determine that weaknesses are corrected.

We reviewed the corrective actions relating to the Cost Allocation System material weakness. Although improvements were made to correct the weaknesses identified in the administrative cost allocation system, we found that not all components implemented the new cost allocation guide. The corrective action has not been implemented because HCFA employee cost data from the regional offices, the Bureau of Program Operations, and the Health Standard Quality Bureau is not being reported correctly. These employee units comprise about 2,380 of 4,440 HCFA employees or about 54 percent. The HCFA also needs to (1) reach an agreement with the OACT on the method to be used in reporting employee activities/output, (2) update their cost allocation guide as offices and bureaus are separated and combined, and (3) obtain bureaus and offices quarterly cost allocation surveys timely. Based on the results of our review, the HCFA Cost Allocation System should be redesignated as a material weakness and included in the Secretary's FY 1993 FMFIA report.

HIGH RISKS AND MATERIAL WEAKNESSES

In monitoring the progress being made by HCFA in resolving high-risk areas and material weaknesses, we reviewed all the pending high risk and material weaknesses as of August 31, 1993. With the exception of MSP, all high risks and material weaknesses are being adequately addressed by HCFA.

We found the MSP corrective action plan does not include procedures for handling the employers who do not participate in the data match. The corrective action plan also does not mention the future benefits of establishing some kind of clearinghouse of information to facilitate avoiding future overpayments. There is also no mention of HCFA's monitoring responsibility regarding the Medicare contractor's MSP operations involving the data match requirements.

FINANCIAL MANAGEMENT SYSTEMS

The FMFIA requires agencies to annually evaluate all financial management systems in accordance with OMB's Circular A-127. The

current policy is to include core accounting systems, OMB specified administrative systems, and program systems which feed financial transactions to the core accounting systems.[8] We believe that all financial management systems should be included which are (1) used to collect, classify, analyze, and report data for financial decision making; (2) process, control, and account for financial transactions and resources; and (3) generate financial information in support of the agency's mission.

For FY 1993, HCFA performed a limited review[9] of its core accounting system, Financial Accounting Control System (FACS) and its subsystems: (1) Accounts Payable, (2) Accounts Receivable/Collections, and (3) Letter of Credit. The subsystem, Time and Attendance, was not reviewed because a new system will be implemented within 2 years. The HCFA also conducted two of four section 2/4 integrated reviews planned for the year. The other two were reclassified to section 2 reviews.

In our FY 1992 FMFIA report, we recommended that HCFA expand its financial management system reviews pursuant to OMB's Circular A-127, including the CWF and Medicare contractors' claims processing systems. The HCFA believes, however, that systems like CWF and Medicare contractor claims processing do not feed financial transactions to FACS, and therefore, do not qualify as a financial management system.

The HCFA has expanded the financial management systems subject to FMFIA section 4 reviews to include the FACS system, including subsystems, as well as 10 section 2/4 integrated systems. We continue to believe that more systems should be subject to section 4 reviews. Our differences with HCFA relate to the definition of the relevant characteristics of a financial management system. The HCFA included in its financial management system inventory, its core accounting system, specified administrative systems, and those systems that have a direct linkage to HCFA's accounting system. We believe other characteristics, such as control over expenditures, data used to develop average pay rates, and claims processing to determine payment amounts, should be considered when identifying financial management systems. For example, because of the financial impact the CWF data has on the presentation of financial data in the Board of Trustees reports, budget preparation, and the accounts payable calculations, HCFA should include this system in its inventory of financial management systems.

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[8] On July 23, 1993, OMB's Circular A-127, Financial Management Systems, was revised. However, guidance from HHS specifies that this new Circular should not be used until FY 1994.

[9] A limited review is required annually of all financial management systems. An integrated or detailed review includes a limited review with transaction testing and is required every 3 years.

Also, Medicare contractors' claims processing systems have a significant impact on the financial data and therefore should be treated as a financial management system and reviewed in accordance with OMB's Circular A-127.

CONCLUSIONS AND RECOMMENDATIONS

The HCFA continues to make improvements to their FMFIA program. During FY 1993, for example, HCFA has developed and implemented in its MCP a segment to cover the Medicare contractors' management controls and financial management systems. We applaud HCFA for these improvements and for their continued efforts to improve their FMFIA program.

We believe, however, the plan still needs improvement to identify the management control procedures Medicare contractors have implemented to provide reasonable assurance that control objectives are achieved. Additionally, HCFA needs to further demonstrate how its estimated 5,200 AMCR reviews adequately address all control objectives and risks. We found that the AMCRs did not identify or prevent control weaknesses in two of three areas we reviewed in detail as part of our FY 1993 financial statement audit. Because of the significant role contractors play in HCFA's operations, we are unable to determine with reasonable assurance that coverage of management controls and financial management systems is adequate. We also found that several other areas need specific attention. The HCFA needs to identify all financial management systems under FMFIA section 4 and to include in its MCP those functions of the OACT which are used to derive financial statement balances.

Accordingly, we recommend that HCFA:

(1) Modify its plan that covers the Medicare contractors' management controls and financial management systems to

- identify detailed management control objectives and risks for major contractor functions,
- reevaluate the identified control procedures to ensure all major controls have been noted,
- reevaluate the present identified AMCRs to the detailed management control objectives, risks and controls, and procedures to determine which controls are covered, and
- perform an assessment of risk to determine which management control objectives are not adequately addressed.

(2) Include in its MCP the functions of the OACT which are used to derive financial statement balances and to comply with the CFO Act for providing sufficient informantion necessary for the completion of the Medicare accounts payable balance audit.

(3) Reconsider all pending material weaknesses and prior period audit reports when HCFA reevaluates the MCA risk.

(4) Expand financial management system reviews to include significant systems such as CWF and contractors' systems.

(5) Ensure that all components have properly implemented the cost allocation system or reestablish the cost allocation system material weakness until fully implemented.

(6) Perform CARs on all corrected material weaknesses.

(7) Reevaluate the corrective action plan for the MSP high-risk area to ensure all significant areas are included.

HCFA's Comments and OIG's Response

In response to our draft report[10], HCFA concurred with recommendations 5, 6, and 7 and disagreed with recommendations 1, 2, 3, and 4. The HCFA deferred comment on our recommendation to reevaluate the review of CWF to ensure that all functional areas are included. This recommendation was deleted because HCFA provided additional evidence that the major functions of CWF were covered in its MCP. After reviewing HCFA's comments and having follow-up meetings with HCFA officials, we modified recommendations 2, 3, and 4 to include HCFA's concerns.

Although HCFA did not agree with the specifics of recommendation 1, it concurred with the intent. The HCFA is taking an alternative approach to address the concerns of the coverage of contractors' controls. It has initiated a major effort to redefine the management control objectives and controls for major contractor functions. Additionally, it has formed a work group, which includes the OIG, to discuss Medicare contractors' management controls and to develop specific recommendations. Although we continue to recommend a different approach to address the coverage of contractors' controls, we will work with HCFA in this area to reach concurrence on an acceptable approach.

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[10] For HCFA's response, see Appendix III.

APPENDICES

REPORTABLE ISSUES OF THE OFFICE OF INSPECTOR GENERAL'S AUDIT UNDER THE CHIEF FINANCIAL OFFICERS' ACT

The following issues are of such magnitude that the OIG believes that they could impact its reports pertaining to HCFA's FY 1993 financial statements under the CFO Act. We continued to apprise HCFA, as well as the Medicare contractors, of the issues and concerns which came to our attention during the course of our internal control work. We acknowledge HCFA's efforts to stay abreast of the emerging issues and concerns through the issuance of its revised Data Call instructions for reporting at September 30, 1993. However, continuing improvement of management controls is essential to ensure that transactions are properly processed and reported in order to be in compliance with the CFO Act and the FMFIA.

ACCOUNTS RECEIVABLE

The Medicare contractors maintain and utilize several financial management systems to accumulate accounts receivable information. These systems, both automated and manual, were primarily designed to track overpayments from different contractor activities. Further, some of the systems utilized to report receivable information, most notably the Provider Overpayment Reporting system, are more reliable than other systems, such as those used for reporting MSP receivables. Overall, however, the contractors do not maintain a fully-integrated accounts receivable system containing attributes such as double entry accrual accounting to facilitate the accumulation of information on an ongoing basis. Accordingly, HCFA has to rely on a reporting process utilizing the HCFA-750 A/B and HCFA-751 (Data Call) which is prepared by contractors to accumulate accounts receivable information for financial statements.

Our assessment of the internal control structure from June 1993 to August 1993 at six FIs and five carriers disclosed that the contractors have generally not established or implemented policies and procedures to ensure the appropriate summarization of accounting data and the reliable valuation of recorded amounts. Specifically, we found that the contractors lacked financial reporting controls needed to

- detect errors and omissions and to evaluate amounts reported on the Data Call;
- ensure that all valid transactions are recorded and properly classified;
- ensure proper cut-off and period-ending closing balances;

- verify the completeness and accuracy of summarized data, and for authorized personnel to review and resolve exceptions;
- ensure that all accounts receivable are included in the receivable balance;
- delineate accounting responsibilities for preparing journal entries and observing accruals; and
- provide for the preparation of financial information by authorized personnel having the sufficient expertise to assure compliance with applicable accounting standards.

We also found the following examples of internal control weaknesses identified at some or most of the contractors:

- Authorization Controls
  - No evidence to show that reconciliations were reviewed and approved by authoritative personnel.
  - Supervisory approval of control bypassing, system overrides, and manual adjustments were not documented.
- Independent Checks
  - Documentation was not retained to support supervisory review.
  - Independent personnel do not reconcile cash receipts control logs to deposit slips and accounting records.
- Design and Use of Documents
  - Departments/units responsible for recording and reporting accounts receivable information did not use prenumbered input documents to ensure that overpayments were recorded to the appropriate period.
  - Cash receipt control logs were not utilized to ensure all cash collected is properly deposited (carrier only).

- Access to Assets and Records
  - Adequate access controls were not in place for the retrieval of data lost or destroyed.
  - Accounts receivable correspondence and checks were not batched and logged by the mailroom.
- Separation of Duties
  - The same individuals were responsible for endorsing checks, preparing and recording deposits, and performing bank reconciliations.
  - The same individuals identified overpayments, prepared and authorized demand letters, received and recorded related cash receipts, and made resulting adjustments and offsets.

Our reconciliation of contractors' June 30, 1993 interim Data Call amounts to their summary reports and supporting documentation disclosed the following financial reporting errors and systems deficiencies at some of the FIs and carriers:

- Reported accounts receivable balances omitted millions of dollars related to MSP receivables. Adequate systems were not in place to record and report on an ongoing basis MSP overpayments identified during the FY.
- Reported accounts receivable balances omitted millions of dollars related to receivables identified by provider audit reimbursement departments.
- Adequate systems were not in place to record and report Peer Review Organization (PRO) and postpayment adjustments. For instance, all pending PRO adjustments were classified and reported as receivables, even though a portion of the adjustments will subsequently be payables.
- Provisions were not established to quantify and report utilization review overpayments related to fraud and abuse, and postpayment cases where a demand letter had been issued. Reported accounts receivable balances were understated in respect to supporting documentation for utilization review overpayments.

- Methodologies used to allocate accounts receivable amounts to the Hospital Insurance and the Supplementary Medical Insurance trust funds were inconsistent or could not be supported.

- Substantial time may elapse between the collection of the overpayment and subsequent adjustment to the accounts receivable records, and as a result the accounts receivable balance could be significantly overstated at the end of the reporting period.

- The HCFA Data Call included a "Reclassified/Adjusted" line item that was used as a "plug figure" to reconcile accounts receivable balances. As a result, there was no support to verify millions of dollars reported in the ending accounts receivable balances.

- The Data Call was not properly followed for reporting receivables written-off, allowances for uncollectible accounts and for aging delinquent receivables.

- Adequate records were not maintained to ensure that the interim Data Call was correctly prepared because a general ledger accounting system is not utilized for Medicare operations.

- Accounts receivable balances were generally compiled by personnel who may not have the accounting background necessary to consolidate and report financial information.

It is important to note that although some of the reporting problems were systemic in nature, several of the reporting deficiencies involved basic clerical errors and omissions. It should also be recognized that the degree of internal control and financial reporting weaknesses vary among the Medicare contractors. Overall, however, the risk is high that the contractors' controls are unlikely to be effective in preventing or detecting material losses, noncompliances, or misstatements on a timely basis.

ACCOUNTS PAYABLE

CONTRACTOR REPORTING AND SYSTEMS DEFICIENCIES

- ♦ Contractors have not established procedures to implement HCFA's Data Call to ensure appropriate summarization of accounting data and the reliable valuation of recorded amounts.

  - • Contractors did not have effective cut-off and period-end closing procedures for accounts payable.

    - o For example, one FI did not recognize the value of unsettled cost reports (value unknown at this time) in its reported accounts payable.

  - • Contractors did not have procedures for verifying or referencing reported payable balances to source documentation and for verifying clerical accuracy.

    - o One FI overstated accounts payable by $55 million because of a computational error.

    - o One FI understated inpatient suspense claims by about $2.5 million due to the use of a number taken from a wrong column on a report.

    - o One FI understated the amount reported for medical review because the amount was calculated using a denial rate instead of an acceptance rate.

  - • Accounts payable amounts reported on the June 30, 1993 Data Call report were not independently verified to, or reconciled with, supporting documentation.

    - o Management at one FI did not review the monthly HCFA 1521 and HCFA 1522 forms.

- ♦ Contractors did not have integrated financial management systems.

- The accounts payable was understated because:
  - One FI did not include over $11 million related to claims returned to providers for additional information.
  - One FI did not include adjustment bills. FI officials stated that the adjustment bills were omitted because the shared system does not capture the dollar amounts. This problem may affect other FIs because it is a shared system deficiency.
- Adequate records were not maintained to ensure the Data Call was correctly prepared because a general ledger accounting system is not utilized for Medicare operations.

SCHEDULE OF HCFA'S FY 1993 AMCR THAT ADDRESS FINANCIAL REPORTING CONTROL OBJECTIVES

These 22 AMCRs were used by HCFA to monitor contractor activities. The footnote explains our evaluation of the AMCRs to contractors' financial reporting control objectives.

FY 1993 AMCRs Per HCFA Documentation	ACCOUNTS PAYABLE		ACCOUNTS RECEIVABLE	
	FI	CARRIER	FI	CARRIER
1. Contractor Performance Evaluation Program - Part A	✓		✓	
2. Contractor Performance Evaluation Program - Part B		✓		✓
3. Regional Home Health Intermediary Performance Evaluation Program	✓		✓	
4. Common Working File Host Performance Evaluation Program	✓		✓	
5. Carrier Quality Assurance System		✓		
6. Medicare Secondary Payer Functional Quality Assurance - Part B				✓
7. Intermediary System Testing Project	✓			
8. Uniform Bill 92 (*)				
9. Ambulatory Surgical Center Pricer		✓		
10. Fee Screens		✓		
11. Lab Fees - Originals		✓		
12. Lab Fees - Update		✓		
13. Carrier Conversion to Statewide Pricing		✓		
14. Crosswalk Codes and Pricing Schedule for 1994 (*)				
15. Durable Medical Equipment Regional Carrier		✓		
16. Data Validation Reviews				
17. Financial Core Requirements Reviews	✓	✓	✓	✓
18. Audit Quality Review Program - Management Reviews	✓		✓	
19. Audit Quality Review Program - Engagement Reviews	✓		✓	
20. Provider Overpayment Report			✓	
21. Physician Supplier Overpayment Report				✓
22. Disaster Recovery/Contingency Reviews				
TOTALS	7	9	7	4

✓ Our review showed the AMCR addressed, to a limited extent, at least one financial reporting control objective for contractor accounts payable and accounts receivable functions.

* Our review showed these AMCRs were not scheduled at contractor locations until FY 1994.

DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care
Financing Administration

Memorandum

Date MAR 21 1994

From Bruce C. Vladeck
Administrator

Subject Office of Inspector General (OIG) Draft Report: "The Health Care Financing Administration's (HCFA) Implementation of the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year (FY) 1993" (A-14-93-03026)

To June Gibbs Brown
Inspector General

We reviewed the above subject draft report on HCFA's implementation of the FMFIA for FY 1993. The objective of the review is to determine whether the FMFIA program is adequate to provide reasonable assurance that management controls and financial management systems detect fraud, waste, and mismanagement.

Our specific comments on the report's recommendations are attached for your consideration. Thank you for the opportunity to review and comment on this draft report. Please advise us if you would like to discuss our comments at your earliest convenience.

Attachment

Comments of the Health Care Financing Administration (HCFA) on Office of Inspector General (OIG) Draft Report: HCFA's Implementation of the Federal Managers' Financial Integrity Act (FMFIA) for Fiscal Year (FY) 1993 (A-14-93-03026)

Recommendation 1

HCFA should modify the plan that covers the Medicare contractors' management controls and financial management systems to:

- identify detailed management control objectives and assertions for major contractor functions.
- reevaluate the identified control procedures to ensure all major controls have been noted.
- reevaluate the present identified alternative management control reviews (AMCR) to the detailed management control objectives, assertions, and procedures to determine which controls are covered.
- perform an assessment of risk to determine which management control objectives and assertions were not adequately addressed.

Response

We believe that some of the findings may be a result of HCFA's use of FMFIA formats and definitions in developing its plan, and OIG's use of controls and definitions relating to the financial statement under the Chief Financial Officers' (CFO) Act. Nevertheless, we would like to provide an update to our activities in this area. During FY 1993, HCFA engaged in a major effort to identify the management control objectives and controls for major contractor functions. This effort was helpful in demonstrating that many of the controls related to proper claims payment were actually external to the contractors, e.g., determinations of eligibility and fee schedules. Although, we found that systems were in place to provide reasonable assurance that transactions are properly authorized, e.g., edit screens in the common working file (CWF), our analysis also revealed that some of the controls relating to activities outside the claims payment process could be enhanced.

To maximize OIG's FY 1993 effort to review internal controls related to the CFO Act, a work group composed of OIG and HCFA staff members has been formed to discuss Medicare contractors' management controls and make specific recommendations for improvements. In addition, OIG has been invited to participate in a number of our Medicare Transaction System (MTS) planning meetings to ensure that OIG and HCFA agree that the MTS will have strong internal controls. We strongly encourage OIG's participation.

In addition, several financial management systems are scheduled for section 2/4 reviews in FY 1994 for contractors, the results of which will be used in the work group's analysis. They are: the Medicare contractor administrative financial management (CAFM) system, the physician supplier overpayment reporting system (PSOR), the provider overpayment reporting system (POR), and the Medicare premium collection systems (SPACE and SOBER). As part of these reviews, control procedures and risks will be identified.

With limited resources available, our priority has focused on those areas that have the highest risk based upon past experience. As we review options to strengthen controls at contractors, we believe OIG could do much to aid our efforts. In particular, it would be very helpful if OIG would provide us with a risk analysis of the controls in question, indicating which areas OIG believes are at high risk but are not being reviewed, and which areas no longer are at high risk but still are being reviewed. This type of information would be helpful in our efforts to determine how OIG's concerns can best be met.

Recommendation 2

Include the Office of the Actuary (OACT) in the Management Control Plan (MCP).

Response

We disagree. OIG bases this recommendation on OACT's responsibility for the development of the Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund and Annual Report of the Board of Trustees of the Supplemental Insurance Trust Fund. These reports include a statement of assets and disbursements for the prior year as well as expected income and disbursements during the current and the next 2 years, and the actuarial status of the Trust Funds.

The actual assets and disbursements are obtained from the Department of the Treasury and reviewed by HCFA's Division of Accounting before incorporation into the HCFA financial statement. OACT has no proprietary interest in the actual numbers. Instead, OACT does analytical work and makes projections for the Trust Funds. These projections are supported by computer systems, but considerable judgment goes into selecting the assumptions underlying each estimate. As previously stated in response to similar recommendations, we will make an effort to look at the systems providing data (which, incidently, are the responsibility of other organizational entities external to OACT).

We understand that OIG will be doing additional audit work within OACT relative to CFO. Based upon this additional work, we would be interested in OIG's concept of what a review of OACT would look like, and what control activities would be reviewed.

Recommendation 3

Reclassify all management control areas (MCA) with pending material weaknesses or Office of Management and Budget (OMB) high risk designations as a high risk.

Response

As stated in our previous response to a similar recommendation, we believe that there are some circumstances where a moderate rating is more appropriate because an MCA may contain several functions, only one of which is affected by the material weakness (MW).

Recommendation 4

Reevaluate the review of CWF to ensure that all functional responsibilities of the system are included.

Response

We defer comment on this recommendation until OIG completes the review of the CWF Host Performance Evaluation Program. Based upon this recommendation, we believe it is necessary to clarify HCFA's segmentation process as well as the review itself. Segments are based on organizational units headed by a responsible manager. The review conducted in FY 1993 titled "Bureau of Program Operations (BPO) CWF" looked at the organization that coordinates software changes to the CWF. The FY 1993 review was not intended to be an all encompassing functional review of CWF, but rather a review of the organizational unit's specific CWF function. Other functional aspects of the CWF are located in other reviews.

Recommendation 5

Expand financial management systems to include significant systems such as the CWF and the Medicare contractors claims processing systems.

Response

We concur. As stated in our response to previous reports on FMFIA, the FMFIA process has been expanded to include those systems identified by OIG. All systems identified by OIG are subject to a section 2 review and some have been added to the section 2/4 inventory.

It should be noted that we will continue to use the Department's definition of a financial system in the designation of activities subject to section 4 reviews.

Additional reviews of the claims processing systems will be considered along with other contractor controls as part of the OIG/HCFA Medicare contractors' control work group effort. Regarding the CWF, we believe it is an editing system, not a claims processing system, and was subject to a section 2 review in FY 1993 in which transaction testing by the contractor was verified.

Recommendation 6

Reestablish the cost allocation system material weakness until all components have properly implemented the system.

Response

We do not concur. Based upon our approach, the FY 1993 cost allocation has been completed for all of HCFA. Since the release of this report, HCFA and OIG agreed upon an appropriate methodology for the cost allocation.

We are also in the process of updating and refining the cost allocation system due to a major reorganization and the initiative to streamline Government. It is our goal to address and correct any problems at that time.

Recommendation 7

Perform corrective action reviews (CAR) on all corrected MWs.

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Response

We concur. To the extent required, we perform CARs on corrected MWs as appropriate. However, some MWs do not require a formal CAR. For example, the Brooks Amendment MW required a General Services Administration delegated procurement authority to bring it to closure. As a result, a formal CAR was not necessary.

Recommendation 8

Reevaluate the corrective action plan (CAP) for the MSP high risk area to ensure all significant areas are included.

Response

We concur. We have reevaluated and updated the Medicare Secondary Payer (MSP) CAP to include the most significant areas OIG believes were not included. If this recommendation is included in the final report, the following points should be taken into consideration.

First, the report states that the MSP CAP does not include procedures for handling employers who do not participate in the data match. In meetings with OIG, it was mutually agreed that HCFA and OIG would work together to implement procedures for handling these employers.

Second, the report also states that the MSP CAP does not mention the future benefits of an information clearinghouse. We note that the Omnibus Budget Reconciliation Act of 1993 established a Medicare/Medicaid data bank that requires annual reporting by employers of their employees and their dependents covered by employment-based health insurance. We are in the process of developing instructions to implement this provision. We are concerned, however, that the data bank requirements may not entirely mesh with provisions that may be included in health care reform legislation. We are continuing to monitor the situation so that we may maximize MSP recoveries.

Third, the report states the CAP should include mention of HCFA's responsibility to monitor contractors' compliance with data match requirements. We do not believe this is necessary since the Contractor Performance Evaluation Program already contains criteria on compliance with MSP requirements, which includes compliance with data match requirements. Therefore, it is duplicative and not cost-effective to require an additional criterion for the data match.

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Lastly, it is not clear what is meant by "the Medicare contractor's MSP operations involving the data match requirement." Milestones relating to the completion of the data match were dropped from the FY 1992 FMFIA annual report after becoming routine. New milestones relating to data match recovery activities were substituted.