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Report to the Administrator, Health Care Financing Administration

March 2000

MEDICARE FINANCIAL MANAGEMENT

Further Improvements Needed to Establish Adequate Financial Control and Accountability

GAO/AIMD-00-66

Contents

Abbreviations

CBS	Center for Beneficiary Services
CFO	Chief Financial Officer
CPE	Contractor Performance Evaluation
EDP	Electronic Data Processing
FFMIA	Federal Financial Management Improvement Act
FSG	Financial Services Group
GMRA	Government Management Reform Act
GPRA	Government Performance and Results Act
HCFA	Health Care Financing Administration
HHS	Department of Health and Human Services
HI	Hospital Insurance
IGLAS	Integrated General Ledger Accounting System
MARS	Medicare Accounts Receivable System
MSP	Medicare Secondary Payer
OFM	Office of Financial Management
OIG	Office of Inspector General
OMB	Office of Management and Budget
ReMAS	Recovery Management Accounting System
SGL	U.S. Government Standard General Ledger
SAS	Statement on Auditing Standards
SMI	Supplementary Medical Insurance

B-284462

March 15, 2000

The Honorable Nancy-Ann Min DeParle
Administrator
Health Care Financing Administration

Dear Ms. DeParle:

Medicare is the nation's largest health insurer, covering almost 40 million beneficiaries at a cost of over $200 billion annually. Addressing the financial management challenges associated with administering the Medicare program is a daunting task given the size and complexity of the program. As the Medicare program steward, the Health Care Financing Administration (HCFA) is accountable for ensuring that funds are spent wisely and in accordance with applicable Medicare laws and that the Medicare program is well managed.

The Congress instituted comprehensive management reforms to assist federal agencies in establishing accountability for programs like Medicare. The Federal Managers' Financial Integrity Act of 1982 (Financial Integrity Act) requires agency managers to annually assess the adequacy of their internal control[1] and accounting systems and report on material weaknesses found and the plans for correcting the problems. The Financial Integrity Act also requires the Comptroller General to issue standards for internal control in government, which were issued in 1983 and recently updated in light of advancing technology and refinements in internal control. The Comptroller General's *Standards for Internal Control in the Federal Government* is issued to help agencies establish and maintain effective internal control systems that are designed to ensure that agencies achieve their goals and objectives.[2]

[1]The term internal control is synonymous with the term management control (as used in Office of Management and Budget Circular A-123) that covers all aspects of an agency's operations (programmatic, financial, and compliance).

[2]The standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, including the use of the entity's resources, and (2) reliability of financial reporting, including reports on budget execution, financial statements and other reports, and compliance with applicable laws and regulations.

Other laws, such as the Chief Financial Officers (CFO) Act of 1990, as expanded by the Government Management Reform Act (GMRA) of 1994, and the Government Performance and Results Act of 1993 (GPRA), prompted agencies to improve financial management, internal control, and performance measurement.[3] The CFO Act and GMRA established CFO positions, required audited financial statements annually, and set expectations for agencies to deploy more modern financial management systems. GPRA required agencies to develop multiyear and annual strategic goals, methods for measuring performance toward achieving those goals, and annual reports on the results.

Like many agencies, HCFA has made strides toward implementing the requirements of recent reform legislation by preparing agencywide financial statements that have been subjected to independent audit since fiscal year 1996. HCFA has made progress in improving its audit opinions each year and just recently received an unqualified or "clean" opinion on its fiscal year 1999 financial statements. At the same time, audits of HCFA's financial statements have continuously cited the agency for serious financial management weaknesses that affect its ability to establish adequate control and accountability for Medicare finances. Many of these weaknesses continued through fiscal year 1999.

[3]Other management reform legislation that has had an impact on financial management includes (1) the Federal Financial Management Improvement Act (FFMIA) of 1996 and (2) the Clinger-Cohen Act of 1996.

The Medicare program has also received increased attention as a result of investigations by the Department of Health and Human Services' (HHS) Office of Inspector General (OIG) and the Department of Justice that cited HCFA's Medicare claims contractors[4] and providers, such as hospitals and physicians, for payment errors and fraudulent billing practices. The OIG estimated that for fiscal year 1999, claims contractors improperly paid an estimated $13.5 billion in Medicare claims, mostly for medical services that were not covered by Medicare or were not reasonable, necessary, or appropriate. Also, we recently reported that although HCFA is implementing several actions to improve its oversight of Medicare claims contractors, organizational and oversight weaknesses impede the agency's ability to ensure that providers are appropriately paid.[5]

Because of our concerns about the impact of continuing financial management weaknesses on the integrity of the Medicare program and the potential for losses, we evaluated HCFA's financial management activities, including evaluation and follow-up on audit findings, monitoring of contractor financial operations, internal financial reporting practices, and financial management improvement initiatives, to determine if they are sufficient to resolve financial management weaknesses identified through annual financial statement audits and other management-type reviews of HCFA's Medicare activities.

Results in Brief

Although HCFA is responsible for ensuring that the billions of dollars expended for Medicare each year are managed in a fiscally responsible way, it has not yet established an adequate foundation for control and accountability over the financial operations of the Medicare program. HCFA's financial management activities, which include evaluation and follow-up on audit findings, contractor monitoring, and financial reporting, are insufficient to resolve the internal control and financial reporting weaknesses identified through audits and other reviews. Resolving these weaknesses is important because of the risk they pose to the Medicare program. Unresolved weaknesses could result in losses to the government.

[4]Contractors are intermediaries and carriers with whom HCFA contracts to administer the Medicare fee-for-service claims.

[5]*Medicare Contractors: Despite Its Efforts, HCFA Cannot Ensure Their Effectiveness or Integrity* (GAO/HEHS-99-115, July 14, 1999).

While HCFA set and achieved goals for improving its audit opinion, many long-standing financial management weaknesses remain. Notably, HCFA received an unqualified or "clean" opinion on its fiscal year 1999 financial statements, and its audit report was issued on time. For HCFA, as well as other federal agencies, annual financial audits represent an important means to assure continued progress in improving financial management and pinpoint significant weaknesses in financial management that require management's attention. In fact, the audit report on HCFA's fiscal year 1999 financial statements highlighted that many of the underlying control weaknesses reported in previous audits still exist.

Financial statement audits have repeatedly cited claims contractors for internal control and financial reporting weaknesses, including failure to safeguard checks received from providers for overpayments and incorrectly recording billions of dollars owed to the Medicare program for such overpayments. Despite the impact that these and other financial management weaknesses have on HCFA's ability to safeguard Medicare assets, HCFA's procedures for following up on audit findings and evaluating corrective actions to ensure they are appropriate and effectively implemented are insufficient.

HCFA's monitoring of contractor financial activities is also insufficient. Until recently, the scope of HCFA's oversight was limited, focusing mainly on contractor compliance with administrative budgets, which total about $1.6 billion annually, instead of focusing on the significant financial activities related to the approximately $170 billion expended each year to pay Medicare benefit claims. Further, HCFA does not routinely analyze contractor financial data to detect irregularities and assess risk as part of day-to-day monitoring activities, nor has HCFA issued complete and up-to-date instructions to contractors on key financial matters.

Audit reports have also cited HCFA for inefficiencies in its internal financial reporting practices, including a lack of documented policies and procedures. Overall, these shortcomings mean that HCFA cannot ensure the reliability of data that the agency and the Congress on an ongoing basis use to track the cost of the Medicare program and to help make informed decisions about future funding.

HCFA officials have begun several initiatives to enhance HCFA's ability to establish better control and accountability, such as hiring outside consultants to evaluate contractor internal controls. These initiatives, if successfully implemented, will assist HCFA in correcting some of its long-

standing financial management problems. However, HCFA does not have a comprehensive strategy to ensure successful implementation of the improvement initiatives, direct financial management activities, and sustain improvements in the long term. HCFA lacks long- and short-range plans that provide a basis for prioritizing financial management initiatives, clearly defining goals and objectives, establishing time frames for completing initiatives, assigning responsibilities, and measuring performance. In addition, HCFA has not completed an assessment of financial management human capital needs. In the absence of a comprehensive strategy, HCFA cannot effectively direct and monitor its many initiatives, potentially putting billions of dollars at risk of fraud and abuse and increasing the likelihood that financial management problems will continue. We are making recommendations designed to help HCFA resolve these problems. In comments on a draft of this report, HCFA generally agreed with our recommendations and described several initiatives it has planned or recently begun for resolving the underlying financial management control issues.

Background

The Medicare program provides health care coverage to people 65 and over and to some disabled persons.[6] For fiscal year 1999, total cost for the Medicare program was over $200 billion, of which about $37 billion was expended for Medicare beneficiaries that opt to enroll in prepaid health care plans commonly referred to as managed care organizations and about $170 billion was expended for the 85 percent of beneficiaries that have chosen Medicare's traditional pay-per-visit or fee-for-service arrangement. Medicare Part A—hospital insurance—covers inpatient hospital, some home health, skilled nursing, and hospice services. Medicare Part B—supplementary medical insurance—covers services provided by physicians, outpatient laboratories, and an array of other providers and supplies.

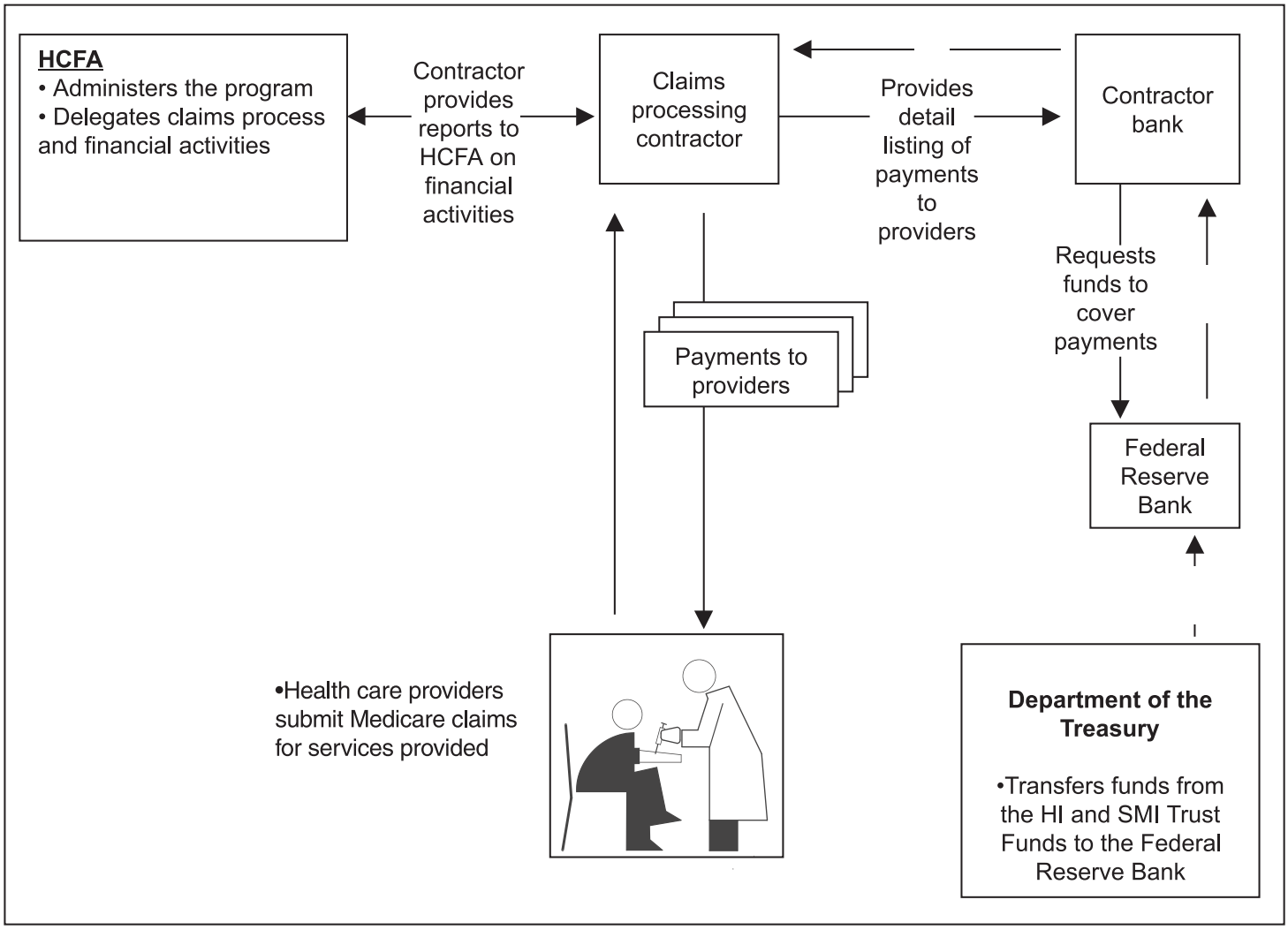
HCFA has primary responsibility for administering the Medicare program. HCFA contracts with 56 Medicare claims contractors to help administer the Medicare program by processing fee-for-service claims, managing the billions of dollars used to pay those claims, protecting Medicare from fraud and abuse, and providing education and services to beneficiaries and

[6]The 1965 legislation establishing Medicare originally covered people 65 and over. Legislation in 1972 broadened the program to cover certain disabled people and those with permanent kidney failure.

providers. Medicare claims contractors are called intermediaries or carriers, depending on the type of claims they process. Intermediaries primarily process part A claims for institutions such as hospitals and home health agencies. Carriers process part B claims submitted by others, such as physicians and suppliers of durable medical equipment. Each business day, contractors process about 3.5 million claims worth an average of more than $650 million.

Medicare claims contractors assume a large share of the responsibility for managing the finances of the Medicare program. Medicare claims contractors have financial management responsibilities that include (1) establishing agreements with commercial banks to withdraw money from the Medicare trust funds and expend those funds to pay Medicare claims, (2) establishing budgets with HCFA to cover the administrative cost of carrying out their Medicare responsibilities, (3) submitting various financial reports to HCFA on activities such as funds withdrawn and funds expended, and (4) certifying that their internal controls are in place and operating effectively. Figure 1 depicts the flow of Medicare program dollars.

Figure 1: Flow of Medicare Program Dollars



Source: GAO analysis of HCFA documentation of Medicare financial management.

HCFA, as the Medicare program steward, is responsible for ensuring that contractors do their jobs accurately and efficiently, including managing Medicare funds in a fiscally responsible manner. HCFA is also responsible for establishing an internal control system to safeguard Medicare assets. To comply with the Comptroller General's *Standards for Internal Control in the Federal Government*, HCFA is required to implement procedures for (1) monitoring claims contractors' internal controls and (2) promptly evaluating audit findings, determining proper actions in response to audit

findings, and completing or directing actions that correct identified deficiencies.

HCFA's monitoring of contractors for both operational and financial performance is a multitiered process. HCFA financial managers rely on two annual processes as their mechanisms for overseeing contractor activities and identifying deficiencies in contractor operation: the annual financial statement audits and the annual Contractor Performance Evaluations (CPE). In addition, HCFA does day-to-day monitoring of contractor operations.

HCFA financial managers rely on the annual financial statement audit done under the CFO Act, as expanded by GMRA, as a tool for oversight of contractors' financial activities. As part of the annual audit of HCFA's financial statements, auditors (1) determine whether Medicare benefit payments were made in accordance with applicable laws and regulations, (2) review the financial reporting and internal control at Medicare contractors and at HCFA's central office, and (3) review regional office oversight of Medicare. When auditors identify specific weaknesses in contractor financial management, HCFA's CFO and its Office of Financial Management (OFM) require contractors to submit corrective action plans to address the deficiencies.

HCFA also relies on oversight of contractor financial activities as performed under annual CPE reviews. CPE reviews are annual reviews to evaluate contractors' performance in all aspects of their contractually required duties. HCFA's central office and its 10 regional offices have shared responsibility for overseeing contractor performance. The central office staff in the Center for Beneficiary Services (CBS) provides guidance and overall direction for contractor oversight. Regional staff generally provide direct oversight and are responsible for annually evaluating contractor activities in the following five areas: (1) fiscal responsibility, (2) claims processing, (3) payment safeguards, (4) administrative activities, and (5) customer service. The CPE review areas most relevant to financial managers are fiscal responsibility and administrative activities. The CPE of contractor fiscal responsibilities requires a review of contractors' compliance with their budgets and other financial reporting processes. Since 1998, regions have completed contractor fiscal responsibility reviews using procedures developed by OFM to evaluate contractors' accounts receivable and accounts payable data.[7] The CPE criteria for contractor administrative activities require HCFA to review contractors' internal controls. When HCFA identifies significant deficiencies in performance, contractors are required to submit a performance improvement plan describing their planned corrective actions to resolve those deficiencies.

OFM is responsible for day-to-day monitoring of contractor financial data and activities in addition to facilitating the annual financial statement audit process, preparing financial statements, and executing daily internal accounting functions. The Financial Services Group (FSG) within OFM (1) collects financial reports from contractors, (2) monitors financial activity such as withdrawals, expenditures, time account analyses, receivables, and payables, (3) issues guidance on contractor internal controls, and (4) incorporates contractor data into HCFA's financial statements. OFM staff are expected to coordinate with HCFA's regional offices for assistance in day-to-day monitoring of contractor financial data.

Objective, Scope, and Methodology

Our objective was to evaluate whether HCFA's financial management activities, including audit evaluation and follow-up, monitoring of contractor financial operations, internal financial reporting practices, and financial management improvement initiatives, are sufficient to resolve

[7]Contractors report basic balance sheet and income statement information on HCFA Form 750 and detailed accounts receivable information on HCFA Form 751.

financial management weaknesses identified through annual financial statement audits and other reviews of HCFA's Medicare activities.

To review HCFA's financial management activities we (1) reviewed audit reports and related documents describing financial management weaknesses identified during audits covering fiscal years 1996 through 1998, (2) reviewed our prior reports on Medicare activities, (3) interviewed various Medicare contractor officials and HCFA officials, including the CFO and staff within HCFA's OFM, CBS, and selected regional offices, (4) reviewed financial management guidance and other documents prepared by HCFA and Medicare contractors specifying financial management and reporting requirements and describing efforts to address identified weaknesses, (5) tested the adequacy of selected controls and the accuracy of reported financial data at selected contractors, (6) reviewed guidance prepared by HCFA for performing key financial management oversight and monitoring activities and related documentation produced as a result of these activities, such as CPE summary reports, (7) reviewed statements of work for contracts between HCFA and outside entities for financial improvement initiatives, (8) reviewed plans prepared in compliance with the CFO Act and the Results Act, such as HCFA's quarterly input to update the HHS' *CFO Financial Management Status Report and 5-Year Plan* and HCFA's performance plans, and (9) reviewed various documents prepared by HCFA describing financial management-related objectives and priorities.

We did our work from June 1999 through early January 2000, at HCFA's central office in Baltimore, Maryland, and at the three HCFA regional offices—Atlanta, Philadelphia, and San Francisco—responsible for oversight of the contractors that we visited. We visited 7 of the 56 Medicare contractors, including 4 previously subjected to CFO audit-related testing. The seven represented a cross-section of large, medium, and small-sized contractors: five are both fiscal intermediaries and carriers, one is a fiscal intermediary only, and another is a carrier only.[8] Collectively, the seven accounted for approximately $44 billion or 26 percent of total expenditures reported by Medicare claims contractors during fiscal year 1999. We did our work in accordance with generally accepted government auditing standards. We requested and obtained written comments on a draft of this report from the Administrator of HCFA. These comments are reprinted in appendix I.

[8]Most intermediaries and carriers are local Blue Cross Blue Shield companies.

Medicare Financial Operations Lack Adequate Control and Accountability

Since fiscal year 1996, auditors of HCFA's financial statements have reported serious weaknesses in accounting, internal control, and financial reporting processes for the Medicare program, many of which continue today. Despite the serious and long-standing nature of these problems, HCFA has not yet implemented adequate processes to improve control and accountability over the Medicare program. HCFA's procedures for evaluating audit findings and following up are not effective to ensure that corrective actions are implemented. In addition, HCFA has serious deficiencies in its oversight and monitoring of contractor financial activities. For example, HCFA's annual oversight reviews are limited in scope, and day-to-day monitoring of contractor financial activities includes little analysis of contractor financial data to detect irregularities. HCFA's guidance to contractors for executing financial activities is incomplete and in some cases outdated. Further, HCFA's internal accounting and financial reporting practices lack documented procedures. These weaknesses in internal control and financial reporting processes pose a risk to the Medicare program because such weaknesses could result in losses to the government.

Significant Financial Management Weaknesses Persist

In its first audit of HCFA-wide financial statements, which covered fiscal year 1996, the OIG cited HCFA for numerous financial management problems. The OIG cited problems with fundamental recordkeeping and financial reporting, incomplete documentation, weak internal control, and financial systems weaknesses that prevented the agency from accurately reporting significant assets and liabilities, such as accounts receivable and accounts payable. In response, HCFA set and achieved goals of improving its audit opinion each year. As a result, after 4 years of audit experience, HCFA received its first unqualified or "clean" audit opinion on its fiscal year 1999 financial statements.

For HCFA, as well as other federal entities, obtaining an unqualified or "clean" audit opinion on its financial statements is an important objective. However, it is not an end in and of itself. The key for agencies is to take steps to continuously improve internal control and underlying financial information for programs like Medicare. As contemplated by FFMIA[9] and

[9]FFMIA requires agencies to substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the *U.S. Government Standard General Ledger* (SGL) at the transaction level.

the CFO Act, HCFA must be able to generate reliable, timely, accurate, and useful information for decision-making on an ongoing basis, not just as of the end of the fiscal year.

While HCFA has made continuous improvement in its audit opinion, many of the underlying internal control weaknesses in HCFA's operations continue. Audit reports prior to the report on HCFA's fiscal year 1999 financial statements included seven significant deficiencies in the design or operation of the Medicare internal control structure.[10] The significant deficiencies included in the 1996 through 1998 audit reports were the result of over 400 specific financial management problems found in contractor and HCFA central and regional office operations. The majority of the specific financial management problems related to contractor operations. Similarly, the report on HCFA's fiscal year 1999 financial statements included many of the same internal control, financial reporting, and electronic data processing weaknesses that had been reported in prior audits. Appendix II summarizes the significant weaknesses identified by the auditors.

In addition, the fiscal year 1999 financial statement audit report cited HCFA's financial systems for continued substantial noncompliance with FFMIA. Specifically, the auditors reported that HCFA does not have integrated accounting systems to capture expenditures at the Medicare contractor level, and certain aspects of the existing financial reporting system do not conform to the financial system requirements currently specified by the Joint Financial Management Improvement Program. At the same time, HCFA was also cited by the auditors for continuing to use processes to prepare its fiscal year 1999 statements that do not effectively accumulate, analyze, and distribute reliable financial information in a timely manner, nor ensure material misstatements are identified in a timely manner.

By obtaining a "clean" opinion on its financial statements, HCFA made progress in addressing one of its significant financial management weaknesses, Medicare accounts receivable.

[10]The audit reports classified the deficiencies as reportable conditions or material weaknesses, which are conditions in which the design or operation of one or more of the internal control components do not reduce to a relatively low level the risk that misstatements caused by errors, fraud, or noncompliance in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties.

For example, HCFA's fiscal year 1998 financial statements resulted in a qualified opinion because HCFA was unable to reliably track accounts receivable worth billions of dollars.[11]

To address the accounts receivable issue, HCFA entered into an interagency agreement with the OIG to review accounts receivable. The OIG review was done to assist HCFA in validating the accuracy and completeness of accounts receivable balances as of September 30, 1998, and March 31, 1999, as well as the activity for the first 6 months of fiscal year 1999. The review provided additional detail on accounts receivable problems that had been previously reported in financial statement audit reports. For example, the October 1999 OIG report identified more than $2.7 billion in accounts receivable overstatements and understatements in amounts reported by contractors and HCFA's central and regional offices. Of the $2.7 billion, $0.7 billion related to receivable balances and activity for claims in which Medicare should be the secondary rather than primary payer (referred to as Medicare Secondary Payer (MSP)). Another $1.8 billion related to balances and activity for non-MSP receivables, which are contractor overpayments to providers, beneficiaries, physicians, and suppliers. In addition, approximately $0.2 billion related to misstatements in accounts receivable tracked by HCFA central and regional offices due mostly to the lack of supporting documentation and improper recording of amounts.

The report states that HCFA and its contractors are unable to properly classify, summarize, and report Medicare accounts receivable activity and balances using current accounting procedures. Contractors use ad hoc spreadsheet applications and a wide variety of claims processing systems for tracking receivables that often cannot be reconciled to control amounts. As a result, some contractors inserted unsupported numbers in the accounts receivable reports to force accounts receivable activity to agree with reported accounts receivable balances. The report also stated that some contractors were unable to support beginning balances for receivables and others reported incorrect activity, including collections.

Recommendations in the OIG report stated that the ultimate solution for HCFA to address many of the accounts receivable problems is the development of a Medicare integrated financial management system for

[11]A qualified opinion states that except for the effects of the matter to which the qualification relates the statements are free from material misstatements.

mandatory use by all contractors. In addition, the OIG also recommended necessary adjustments for some of the $2.7 billion in over-and-under statements to properly present the ending accounts receivable balances as of March 31, 1999.

Recognizing that the ultimate solution to its accounts receivable problems will take years to implement, HCFA implemented procedures to eliminate or write off accounts receivable balances as had been recommended in previous financial statement audit reports. HCFA wrote off almost $3 billion of Medicare accounts receivable balances for fiscal year 1999. The almost $3 billion in accounts receivable being written off consists of $0.8 billion in non-MSP receivables (i.e., receivables that represent contractor overpayments to providers, beneficiaries, physicians, and suppliers) and $2.1 billion in MSP receivables (i.e., amounts owed by other insurance companies that should have been primary payers). Support provided to us during our review did not clarify how the adjustments recommended by the OIG report relate to the amounts being written off. However, HCFA officials stated that they worked closely with the auditors to ensure that there was little to no overlap between the adjustments and write-offs.

HCFA officials stated that the $3 billion in receivables is being written off in accordance with policy endorsed by the CFO Council or because regulations preclude further collection action. HCFA officials also explained that using tools provided by the Debt Collection Improvement Act, they will refer some of the debt to the Department of the Treasury for further collection. However, given the nature of some of the amounts being written off, there is little likelihood of any future collections. For example, the amounts being written off include debts owed by entities no longer in business. Also, some of the write-offs are the amounts that HCFA has determined may never be repaid due to either the age of the accounts receivable or the lack of detailed records to substantiate the validity of the debt. HCFA is writing off all balances that are (1) over 10 years old, (2) from 6 to 10 years old, with no collection activity in the past 12 months, or (3) not supported by detailed records. It may be a normal industry practice and consistent with federal laws and regulations to write off accounts receivable balances that are deemed “uncollectible”, but such actions are troubling for taxpayers and a concern for a program like Medicare where total costs borne by the elderly are rising at the same time that billions of dollars are being written off. HCFA officials said that they expect to solicit outside assistance again next year to assess the accounts

receivable amounts because the underlying accounts receivable systems problems still exist.

Audit Evaluation and Follow-up Procedures Were Ineffective

Evaluating the financial management problems identified during audits and implementing follow-up procedures is critical if HCFA is to resolve its financial management problems and establish financial accountability. The Comptroller General's *Standards for Internal Control in the Federal Government* requires that agencies implement actions to ensure that the findings of audits and other reviews are promptly resolved. Among the steps to ensure that findings are promptly resolved is determining that proper actions have occurred in response to findings and recommendations. Moreover, the Office of Management and Budget's (OMB) implementing guidance for the Financial Integrity Act[12] emphasizes the importance of agency management taking timely and effective action to correct identified deficiencies. Responsibility for correcting deficiencies is an integral part of management accountability and should be considered a priority by the agency.

As of January 2000, HCFA's procedures for ensuring that corrective actions are effectively implemented to resolve financial management related audit findings were ad hoc at best. The one documented audit follow-up practice that HCFA has consistently taken is preparing a quarterly corrective action plan that lists the actions HCFA plans to implement to address the significant findings of the financial statement audit report, including material weaknesses and reportable conditions. This corrective action plan is included in the HHS' annual *CFO Financial Management Status Report and 5-Year Plan*, required by the CFO Act. HCFA's corrective action plans for fiscal years 1997 and 1998 included specific steps to address some of the financial management related weaknesses. However, our review showed that the plans lacked sufficient detail on corrective actions to address other key financial management weaknesses that impact the reliability of data used to track financial activities of the Medicare program and to help make informed decisions. For example, the fiscal year 1998 corrective action plan did not include detailed steps or target completion dates for correcting (1) the inadequacy of HCFA's procedures to detect errors in data used in Medicare accounts payable estimates, (2) the lack of regional office oversight to monitor the reliability of contractor reports on Medicare funds expended, and (3) the lack of contractor control

[12]OMB Circular No. A-123 Revised, June 21, 1995, *Management Accountability and Control.*

procedures to provide independent checks of the validity, accuracy, and completeness of amounts reported to HCFA.

In discussions with HCFA officials about the lack of specificity in its financial statement audit corrective action plans, HCFA officials explained that more detailed steps to address each audit finding are provided by contractors in the corrective action plans that HCFA requires them to submit. According to HCFA OFM staff, since the fiscal year 1996 audit, HCFA has asked its claims contractors to develop and implement corrective actions that address the deficiencies identified by the financial statement auditors. The contractors' corrective action plans are to be sent to OFM for review and approval. However, HCFA has not established written procedures for tracking receipt of corrective action plans prepared by contractors.

While OFM staff could describe their procedures for tracking contractor corrective action plans, they said they were just beginning to document them. OFM provided us with draft written procedures that describe the process. However, when we requested copies of the contractors' corrective action plans addressing the fiscal year 1998 audit, OFM officials said they were not available because the CFO audit coordinator had failed to request them from the contractors. OFM eventually provided us copies of the corrective action plans after they requested them from the contractors more than 6 months after the completion of the fiscal year 1998 audit. While the contractor corrective action plans included steps to address the audit findings and target completion dates, we found that HCFA does not follow up at contractor sites to ensure that corrective actions are being implemented.

HCFA has not developed written procedures that require HCFA central or regional office staff to follow up at contractor sites, although HCFA officials had plans to do so. The Financial Integrity Act requires agency management to track progress to ensure timely and effective results. However, OFM staff said that until they implement procedures to ensure that HCFA staff follow up at contractor sites, they would continue to rely on the auditors to follow up as part of subsequent year financial statement audits. Since the first audit, auditors have followed up with 24 of the 41 contractors included in audits of fiscal years 1996, 1997, 1998, and 1999 financial statements. However, the auditors did not follow up with 12 of the 41 contractors because they were not included in subsequent audits. The other five contractors no longer participate in the Medicare program.

Weaknesses in HCFA's follow-up have hindered prompt resolution of financial management problems. In fact, during our contractor visits for this review, we found that several contractors included in previous audits had weaknesses in their internal controls over Medicare activities similar to weaknesses found in previous audits. For example, two contractors did not have adequate control procedures in place for independent review of key financial data reported to HCFA on funds expended and bank account activity. Also, these two contractors did not have adequate controls to ensure the accuracy of the outstanding check amounts reported to HCFA. For the two contractors, outstanding check amounts totaled over $100 million as of September 30, 1999.

We also found that OFM did not implement procedures to evaluate whether the financial management problems identified at the contractors under audit are systemic in the operations of contractors not included in the audit. Our review found that two contractors not included in previous audits had problems in controls over cash and review of financial data, similar to findings reported at contractors in prior audits. For example, one contractor that receives cash from providers and other sources averaging about $20 million a month did not physically secure checks while awaiting deposits, thus increasing the risk of lost checks and untimely deposits of Medicare funds. Another contractor with cash receipts of about $1.5 million monthly did not record the amounts in a log when first received, thus creating opportunities for theft.

Oversight of Contractor Financial Activities Is Limited in Scope

When daily financial operations of a program as complex as Medicare are delegated to outside entities, oversight mechanisms are important tools for maintaining financial control and accountability. The Comptroller General's *Standards for Internal Control in the Federal Government* states that with increased delegation of authority and responsibility, agency management should have effective procedures to monitor results and hold individuals accountable for their decisions and actions. In delegating authority to accomplish an agency's mission, a critical internal control challenge is to delegate enough to achieve the objectives of the agency, but not so much that internal control is significantly weakened. In addition, the standards state that because conditions change over time, agency management must determine if internal control continues to address new or changed risks by implementing a combination of ongoing monitoring activities and separate evaluations. Ongoing monitoring activities are performed continually to provide important feedback on the internal control and are usually more effective than separate evaluations. Separate evaluations of control can be

useful because they focus directly on the controls' effectiveness at a specific time.

HCFA's oversight of contractor financial activities for the Medicare program has not focused on ensuring that contractors have the necessary internal controls in place to account for and report on all financial activities related to the Medicare program. Until fiscal year 1998, HCFA's CPEs, the primary tool for evaluating contractor operations, included limited review of contractor financial activities and the controls over those activities. HCFA regional office CPE reviews of contractor financial responsibilities largely focused on contractor compliance with the annual budget HCFA establishes to pay contractors for administering the Medicare program—approximately $1.6 billion a year. The financial responsibility reviews did not focus on some of the significant financial activities and data related to the about $170 billion expended each year to pay providers' claims, such as Medicare accounts receivable, accounts payable, and funds withdrawal activities. In addition, regional oversight reviewers did not adequately examine contractor internal controls to gain assurance that contractors' reports on financial data were reliable.

In the past, HCFA officials have raised concerns about having the necessary resources, including the staff expertise, to provide oversight in critical areas such as financial management and review of contractor data. For example, we reported in July 1999 that HCFA officials believe that staff resources were not adequate to perform detailed testing and validation procedures necessary to ensure the accuracy of contractor-reported data.[13]

The Comptroller General's *Standards for Internal Control in the Federal Government* states that an agency's control environment is significantly affected by the competence of its personnel and the agency's ability to (1) identify appropriate knowledge and skills needed for various jobs and (2) provide needed training to maintain skill levels for particular jobs.

HCFA's difficulties in applying resources to oversight activities in the past resulted in limited examination of essential contractor financial data thus limiting the information HCFA has to assess the integrity and reliability of contractor operations and develop solutions.

[13]GAO/HEHS-99-115, July 14, 1999.

Recognizing the shortcomings of the HCFA annual oversight process, in fiscal year 1998, the CFO took steps to address weaknesses in oversight of financial activities. HCFA's OFM developed procedures for the regions to use in checking and testing financial data related to accounts receivable and accounts payable for several of the large contractors. OFM also provided staff to assist regional reviewers in an attempt to develop and leverage the skills and expertise of staff conducting the reviews.

Although several reviews were done under the new approach, the reviews were not sufficient to address the serious deficiencies in contractor data for accounts receivable and accounts payable identified from previous audits because the scope of the procedures was limited. The procedures required testing of only a few receivable amounts at each contractor site selected from various types of reported receivables balances and related activity. The procedures did not require the selection of tested items to be based on a statistically valid selection methodology. OFM staff explained that the procedures were not developed as a detailed audit tool; therefore, they do not include the level of testing that audit procedures would include. OFM staff said that the procedures were developed to give HCFA indications of possible receivable problems that require additional review.

HCFA could better identify the root causes of receivable problems and enhance the agency's ability to address the problems if tests were performed on a larger number of items that are selected based on the nature and size of the various receivable-related populations and if a statistically valid methodology is used for selecting the items.

Similarly, we found deficiencies in the accounts payable audit procedures. The procedures did not provide reviewers with guidance for determining the number of items to select for testing and for performing procedures to ensure that all payable amounts are accounted for. As a result, HCFA reviewers may have been limited in thoroughly evaluating the accuracy of contractor-reported accounts payable data.

The procedures did not cover other key financial activities, such as contractor bank balances and funds withdrawal procedures. Contractors and the commercial banks that act on behalf of contractors withdraw the approximately $170 billion required annually to pay Medicare benefit claims. Despite the magnitude of dollars that flow in and out of contractor bank accounts, HCFA has not developed detailed procedures to review contractor bank balances and the amount of funds withdrawn. We have discussed with the CFO the need for expanded evaluation procedures to

cover these areas. The CFO agreed and has begun discussions with officials in the HCFA headquarters unit responsible for contractor oversight about expanding financial management oversight.

In fiscal year 1999, instead of relying solely on CPE reviews for financial management oversight, the CFO solicited outside help to assess (1) accounts receivable balances reported by contractors and (2) contractor internal controls. As discussed earlier, HCFA entered into a reimbursable interagency agreement with the OIG to assess the accuracy and controls over reported accounts receivable. HCFA also contracted with outside consultants to validate internal control at contractors in response to a GAO finding that HCFA does not regularly check contractors' internal controls.[14]

HCFA officials said that they plan to continue both the accounts receivable and internal control reviews in the future. While these two efforts demonstrate that HCFA is acting to address its longstanding problems, we are concerned that HCFA's financial managers have not taken steps to comprehensively assess how the agency will sustain strong oversight in these two areas in the future or address the recommendations that will likely result from these reviews. For example, financial managers have not completed assessments of HCFA's human capital needs for oversight of contractor financial operations in a coordinated effort with the central office unit and regional offices responsible for oversight. It is also unclear whether HCFA's financial managers plan to continue developing and improving procedures for oversight of contractor financial operations through CPEs or if such procedures will be replaced and supplemented by outside consultant reviews.

Day-to-Day Monitoring of Contractor Financial Activities Is Insufficient

In addition to annual CPEs not providing adequate oversight of contractor financial activities, HCFA's day-to-day monitoring of contractor data has also been insufficient. HCFA does not routinely analyze key contractor financial data to detect irregularities in contractor financial activities and assess risk, despite the importance of such mechanisms in establishing sound internal control. In addition, accountability for several of HCFA's day-to-day monitoring practices has not been clearly defined.

[14]GAO/HEHS-99-115, July 14, 1999.

The Comptroller General's *Standards for Internal Control in the Federal Government* states that ongoing monitoring activities should include comparisons and reconciliations to identify inaccuracies or exceptions that alert management to any internal control problems. The standards also state that agency internal control should provide for assessing the risks that an agency faces by estimating the significance of identified risks, assessing the likelihood of occurrence, and deciding how to manage the risks. Another important control activity included in the standards is assigning authority and responsibility in a manner that ensures each individual knows how his or her actions interrelate and contribute to meeting the agency objectives.

Despite the billions of Medicare dollars flowing through contractor bank accounts and the risk posed by these activities, HCFA does not have adequate mechanisms that indicate whether bank activity conducted on behalf of contractors is reasonable. In early 1999, examiners from the Federal Deposit Insurance Corporation discovered and reported to HCFA that one bank, which provides banking services for eight contractors, had a practice of drawing funds from the U.S. Treasury on the day before the bank needed the money to pay Medicare claims. The bank was selling the amount to another bank overnight to earn interest and transferring it back to its accounts the next morning without HCFA's knowledge. When HCFA was made aware of the situation, the CFO issued a letter to the bank president to (1) inform the bank that the practice was not in accordance with provisions of the Medicare program bank agreement and Treasury's regulations concerning collateral requirements for federal funds and (2) request that the bank immediately stop the practice. However, because HCFA does not routinely monitor information on contractor bank activities and does so little analysis, it could not fully determine the extent of irregular activities by this bank.

At the request of HCFA, the OIG is currently investigating the bank in part to determine the amount of profit the bank made from this practice. HCFA officials said that they are awaiting the results of this report to determine what actions against the bank are needed, including disciplinary actions. In addition, HCFA officials said that they requested the OIG to conduct a separate review of bank procedures for a sample of banks participating in the Medicare program to determine if other banks are unfairly profiting from similar practices and to identify areas of potential vulnerability.

HCFA does not routinely analyze other data critical to ensuring the integrity of contractor operations. For example, the contractors'

reconciliation of "total funds expended" is an important control which ensures that all amounts reported to HCFA by Medicare contractors are accurate, supported, complete, and properly classified. The reconciliation requires contractors to reconcile total monthly expenditures to the number of Medicare claims processed and to payment amounts including (1) periodic interim payments to providers that cover their estimated cost of providing Medicare services, (2) cost settlement payments that cover the difference between provider periodic interim payments and actual costs incurred, and (3) cash recovered from provider overpayments. Contractors must reconcile the expenditure amounts listed with detailed supporting data from their financial records and systems. HCFA requires that the contractors prepare and submit the reconciliations monthly, but it does not track receipt of them or review the reconciliations to detect irregularities or assess risk. By not reviewing these reports and requesting the supporting schedules necessary to ensure the accuracy of amounts reported by Medicare contractors, HCFA's ability to hold Medicare contractors accountable for submitting accurate financial data is hindered.

HCFA financial managers explained that they do not analyze the reconciliations received from all contractors because they do not receive any supporting documents from the contractors to determine if the amounts are accurate. Although such analysis is an agency management responsibility, HCFA relies on the OIG review of the reconciliations that are done for the sample of contractors selected as part of the annual financial statement audit. HCFA officials said that they do not currently perform any procedures for the other contractors not selected for the audit.

HCFA could analyze certain reconciliation amounts reported over time to obtain useful information for monitoring all contractors, although contractors do not submit supporting schedules for each amount. Analyzing significant increases or decreases in the amounts of various types of expenditures and receipts for overpayment recoveries reported on the reconciliation could indicate whether a contractor is experiencing difficulties. For example, an analysis identifying a significant decrease in monthly receipts for overpayments could assist in highlighting potential collection problems. Similarly, an analysis identifying a significant decrease in cost settlement payments could assist in highlighting potential problems related to the contractors' processing of provider cost settlements.

In evaluating HCFA's monitoring activities, we also found that some HCFA staff are not aware of the extent to which they are accountable for certain agency activities. For example, HCFA's monitoring activities are supposed

to be carried out by staff in OFM at HCFA's central office and with assistance from staff in the regional offices. HCFA receives monthly and quarterly contractor financial data related to (1) contractor bank charges and collateral, (2) contractor withdrawals and expenditures for benefits, (3) contractor administrative withdrawals, and (4) contractor accounts receivable and payable. However, we found that clear lines of responsibility have not been established for analysis done by OFM and the regions, and analysis is limited.

OFM has one staff person that monitors the Medicare bank account balances—about 20 commercial banks maintain the accounts for the 56 Medicare contractors. The staff person said that because of other responsibilities, he only reviews bank account reports for about 2 or 3 of the 56 Medicare contractors each quarter. When we asked to review his analysis, the staff person could not provide any support or written analysis procedures. The OFM staff person told us that regional staff might routinely analyze bank activity, but he does not coordinate with the regions to ensure that they do. Staff at the three regions we visited told us that they do not routinely analyze contractor bank balances and referred us to the OFM staff person.

Contractors Lack Sufficient Guidance to Resolve Financial Management Deficiencies

HCFA's ability to address long-standing financial management weaknesses is also hampered because financial managers have not issued complete, up-to-date guidance to contractors for financial activities. Contractors we visited said they need additional guidance from HCFA to assist in correcting control weaknesses. According to contractors, one specific area where instructions are needed is the allocation of cash receipts between the two Medicare trust funds.[15] Because HCFA has not issued specific instructions in this area, contractors have adopted different methodologies that in some cases lead to inaccurate trust fund balances. One contractor adopted a procedure where all overpayments received were allocated to the Hospital Insurance (HI) trust fund. The contractor did not take any steps to determine if the overpayments were related to previous Supplementary Medical Insurance (SMI) or HI benefit payments. After adopting procedures to determine if receipts were related to HI or SMI, the

[15]Congress established two trust funds for Medicare. The Hospital Insurance (HI) trust fund is used to pay Medicare Part A claims and is funded primarily by employment taxes. The Supplementary Medical Insurance (SMI) trust fund is used to pay Part B claims and is primarily funded by Medicare premiums and a federal matching contribution.

contractor reviewed its allocation for a 9-month period in fiscal year 1999 and found that $33 million, which should have been allocated to the SMI trust fund, had been incorrectly allocated to the HI trust fund. This error is significant because accurate data on Medicare trust fund balances are essential in managing and monitoring trust fund activities and funding needs.

HCFA's CFO acknowledged that more detailed instructions to contractors are needed because HCFA's contracting documents do not include enough specificity to contractors on their fiscal responsibilities. Also, we found several financial-related sections of the contractor manuals that had not been updated since the 1970s. Because HCFA lacks baseline data on its financial management instructions, it has hired a contractor to determine what financial guidance has been issued and to develop a manual of financial and internal control guidance. This effort has just begun, and it is too soon to tell whether it will succeed in addressing these fundamental problems.

HCFA Lacks Structure for Internal Financial Reporting Practices

Past financial statement audits have identified weaknesses in HCFA's internal financial reporting processes. Specifically, auditors reported that significant staffing constraints within HCFA's Division of Accounting limit its ability to conduct the annual financial statement preparation process and contribute to lax procedures and controls for preparing and safeguarding financial data. However, HCFA has not acted to ensure that it has knowledgeable financial management staff and clearly documented procedures for executing accounting and financial reporting activities.

HCFA's financial statement reporting process is not clearly documented. Uniform policies and procedures for the financial statement preparation process are critical to ensuring that accounting personnel can produce complete, accurate, and consistent financial statements in a timely manner. However, HCFA's current financial statement preparation process relies primarily on the experience of a few key personnel who have prepared the financial statements in previous years. The key personnel have not documented their procedures. This approach renders HCFA vulnerable to loss of financial reporting institutional knowledge through normal staff attrition, and thereby creates significant risks that information supporting the financial statements will not be complete, accurate, properly authorized, and consistent from year to year.

We also found that HCFA does not have an updated accounting manual to direct accounting staff in performing routine accounting procedures for the Medicare program. OFM officials said that staff are instructed to use accounting guidance provided by HHS and tailor the guidance as necessary. A recent error in HCFA's financial reporting demonstrates the importance of written accounting procedures that are specific to HCFA operations. In October 1999, HCFA discovered misstatements in its reports to Treasury on amounts expended from the HI and SMI trust funds. Treasury relies on the amounts reported for expenditures because Medicare trust fund amounts not necessary to meet current expenditures are invested in interest-bearing securities of the U.S. government each month.

Senior OFM officials said that the staff person who prepared the report had assumed responsibilities of a former employee but had not received adequate training. Because of HCFA's errors, the Medicare trust fund balances that Treasury invested for several months were incorrect, thus resulting in a loss of investment interest income of about $80 million to the Medicare program.[16] HCFA is currently taking steps to enhance its procedures for reporting trust fund balances.

HCFA Lacks a Comprehensive Financial Management Strategy

HCFA has not developed a comprehensive strategy to direct its financial management activities. A comprehensive financial management strategy, along with plans for implementing the strategy, is important because of the size and complexity of the Medicare program and the recurring financial management weaknesses and problems identified by HCFA's auditors. A key part of HCFA's strategic planning should be assessing human capital because managing an organization's employees is essential to achieving results. Without a comprehensive plan for improving financial management, resolution of problems may be delayed and the billions of dollars related to the Medicare program will continue to be at risk.

[16]Although incorrect balances in the Medicare trust funds resulted in a net loss of interest income to the Medicare program, other Treasury investments earned the interest lost by the Medicare program. As a result, these events did not result in a net loss to the U.S. government.

HCFA Lacks Plans for Implementing Financial Management Improvement Initiatives

While HCFA has several initiatives underway to improve financial management and operations, it has not developed a comprehensive implementation plan. A comprehensive plan would include long- and short-range plans with clearly defined objectives and goals. The plan should include specific corrective actions and target dates and resources necessary to implement those actions. A comprehensive plan would also assign accountability by identifying offices and staff responsible for carrying out the corrective actions. Establishing accountability is important for increasing the chances of successful implementation and outcomes.

HCFA prepares agencywide strategic plans and annual performance plans as required by GPRA and provides input into the HHS' annual CFO 5-year plan required by the CFO Act; however, these plans are broader in scope and focus on different goals and objectives. They do not provide an adequate substitute for a specific HCFA financial management improvement plan. Also, each division and branch of OFM sets annual unit work priorities. These priorities likewise do not adequately substitute for a financial management plan because their focus is narrower.

HCFA has initiated several projects intended to correct problems identified during financial statement audits. These projects include (1) developing an integrated accounting system to include both overpayment tracking and financial reporting, (2) developing two new systems to improve oversight and financial reporting over Medicare receivables, (3) reviewing contractors internal control, and (4) developing a comprehensive contractor financial management manual. (See appendix III, which contains more information on these projects.) While these projects have the potential to provide major improvements in HCFA's financial management, the chances of success could be significantly improved if HCFA established and documented a specific implementation plan for completing the projects and using the results. HCFA officials provided us broad conceptual ideas of how the initiatives would need to be implemented. However, as of January 2000, HCFA was in the early stages of drafting more specific details for these projects.

For example, three of the initiatives involve developing new financial management systems to improve oversight and financial reporting over Medicare receivables and developing an integrated accounting system. While these systems are in their early design phases, HCFA has not fully developed detailed plans for coordinating implementation and integration of these systems. One step HCFA officials stated that they have taken is to hire an experienced systems design specialist to lead the integrated account system project. Still, delays in developing detailed plans could cause problems as the projects progress. In January 1999, we issued a special series of reports[17] that discusses major management challenges and program risks that must be addressed to improve the performance, management, and accountability of federal agencies. In this series of reports, we reported that a challenge for agencies is to ensure that modern information technology management practices are consistently defined and properly implemented. As underscored by the Clinger-Cohen Act,[18] complete and enforceable systems architectures—blueprints to guide systems development—are essential foundations on which the interoperability and coordination of related business processes and systems are built. Lack of well-defined systems architectures often leads to problems in systems interface and data exchange, confusion for users, and delays in program operations.

Another financial management improvement initiative that HCFA has underway is to review contractors' internal control structures to identify poor internal control and needed improvements. HCFA has contracted with independent public accounting firms to perform these reviews. A documented, comprehensive plan is important to avoid duplication of effort when conducting these reviews. Auditors of HCFA's financial statements have already reviewed the internal controls of some of the Medicare contractors included in these reviews. HCFA officials envision that these contracted reviews will continue in future years, but HCFA has not determined what resources will be needed to do the reviews or respond to the resultant recommendations. In addition, HCFA officials do not have alternative plans in the event these reviews cannot be continued. Without alternative plans, this critical activity could be interrupted.

[17] *Major Management Challenges and Program Risks: A Governmentwide Perspective* (GAO/OGC-99-1, January 1999).

[18] The Clinger-Cohen Act of 1996 builds on the best practices of leading public and private organizations by requiring agencies to better link information technology planning and investment decisions to program missions and goals.

The project to develop a comprehensive contractor financial management manual, which is well underway, also lacks a clear plan for how the manual will be used. Documentation for the project consists of a statement of work describing the procedures an independent consultant is to perform to develop the manual. HCFA has not documented plans for how it intends to implement the new manual, including (1) how training will be provided and (2) how the manual will be kept current.

Assessments of Human Capital Needs Are Incomplete

Effectively managing an organization's employees—or human capital—is essential to achieving the goals of the organization. The CFO Act recognizes the importance of human capital to achieving financial management objectives by stating that an agency CFO shall direct, manage, and provide policy guidance and oversight of agency financial management personnel, activities, and operations, including the recruitment, selection, and training of personnel to carry out agency financial management functions. Similarly, a comprehensive financial management strategy at HCFA should include human capital planning.

We issued an exposure draft of an executive guide designed to help federal agencies achieve federal financial management objectives.[19] The guide discusses best practices of leading private and public sector finance organizations. One of the best practices for creating world-class financial management is to build a team that delivers results. Our guide identified leading finance organizations that have developed finance teams with the right mix of skills and competencies. The guide offers three critical elements for developing a first-rate team: (1) determining required skills and competencies, (2) measuring the gap between what the organization needs and what it has, and (3) developing strategies and detailed plans to address current or expected future deficiencies.

HCFA officials stated that they recently initiated an agencywide workforce planning project. This project consists of a four-phased model that plans to incorporate critical elements similar to those mentioned in our guide. To date, the results of this project have provided HCFA with limited information, and more detailed assessments to analyze current and future work functions and competencies have not been completed. HCFA's current plans are to use results from its project to formalize hiring, staffing,

[19] *Executive Guide: Creating Value Through World-Class Financial Management* (GAO/AIMD-99-45, August 1999, exposure draft).

and learning plans for fiscal year 2001. Having staff with appropriate skills is key to achieving financial management improvements. Currently, HCFA officials acknowledged that they are constrained by the resources and staff skills available to perform financial functions such as analysis of financial data to detect irregularities and internal financial reporting processes. Given the limited resource and staff skills available to perform key financial functions, emphasis on completing more detailed human capital planning within HCFA's proposed time frames is important.

We recently issued a discussion draft that provides a human capital self-assessment guide to help agencies assess their human capital systems and identify both the opportunities available and barriers standing in the way.[20] Agencies that focus on valuing employees and aligning their policies to support organizational performance goals start with a human capital assessment. Part of the impetus for valuing human capital comes from GPRA, which requires agencies to pursue performance-based management, including strategic planning, results-oriented goalsetting, and performance measurement. The results of such an assessment could help determine the resources needed to implement the comprehensive financial management plan. Further, without a formal assessment of its requirements and needs, and a strategy for addressing them, HCFA's efforts can become piecemeal and incomplete. A comprehensive needs assessment and plan, including time frames for improving its human capital position, could also strengthen the agency's ability to support its human capital budget requests.

[20] *Human Capital: A Self-Assessment Checklist for Agency Leaders* (GAO/GGD-99-179, Sept. 1999).

A comprehensive financial management strategy is a crucial tool for financial managers. A sufficiently detailed strategy that includes a plan for integrating the implementation and results of each of HCFA's financial management improvement initiatives, including the human capital resources needed, would provide a "road map" for HCFA's management and staff to help in resolving financial management problems and ensure Medicare funds are spent responsibly. We have testified that congressional committees, as part of annual appropriation or oversight hearings, could use agencies' corrective action plans, along with financial statement audits and other financial related reports, to measure the progress agencies are making toward improving financial management. [21] We have also discussed the need for the plans to be sufficiently detailed so that agency management and staff can resolve financial management problems.

Conclusions

With billions of dollars at risk in the Medicare program, the importance of ensuring that Medicare assets are properly accounted for and that adequate controls are in place to safeguard them cannot be overstated. In this respect, HCFA continues to face difficulties. Financial statement audits and other assessments and reviews have identified significant financial problems at HCFA and its Medicare contractors year after year. Despite these problems, HCFA's follow-up on audit findings and recommendations, evaluation of contractors' corrective action plans, analysis of available financial data to detect inappropriate financial management activities, and financial guidance for HCFA and contractor staff is limited. Further, it is difficult for HCFA to improve and expand oversight of contractor financial operations without first determining the required staff skills and competencies needed. In addition, HCFA's internal financial reporting processes render HCFA vulnerable to errors in critical data needed to administer the Medicare program.

The significance of the financial management issues facing HCFA emphasizes the need for a comprehensive strategy to direct its financial activities and assess its human capital needs. This strategy would help HCFA establish seamless systems and processes to improve financial management and accountability.

[21] *Financial Management: Fostering the Effective Implementation of Legislative Goals* (GAO/T-AIMD-98-215, June 1998).

Recommendations

To improve financial management and accountability in the Medicare program, we recommend that the HCFA Administrator direct the Chief Financial Officer to take the following actions:

- Improve procedures for evaluating and resolving findings from annual financial statements audits by developing, documenting, and implementing procedures so that managers promptly evaluate audit findings, determine proper actions in response to audit findings, and complete within established time frames all actions that resolve the findings brought to management's attention.
- In developing the procedures, coordinate with the central and regional office staff responsible for contractor oversight to ensure that resources are applied appropriately for timely follow-up with contractors on implementation of corrective actions to address financial statement audit findings.
- Improve oversight of contractor financial activities by working with the central and regional office staff responsible for annual contractor performance evaluations to (1) refine and expand procedures for review of contractor financial activities, (2) provide staff with the necessary skills to evaluate contractor financial activities, and (3) identify specific contractors and financial activities to be reviewed.
- Improve the agency's ability to detect irregular financial activities and identify high risk contractors by (1) developing analysis and risk assessment procedures that detect unusual variances and patterns in the amounts of funds withdrawn, funds expended, bank balances, accounts receivable, accounts payable, and other key financial data reported by contractors and (2) coordinating and sharing analysis and risk assessment methodologies with central and regional office staff responsible for contractor monitoring and oversight.
- Improve guidance to contractors for executing Medicare financial activities by ensuring that the current initiative to develop a comprehensive contractor financial management manual (1) solicits input from contractors on the areas where better guidance is needed to address long-standing internal control weaknesses, such as specific instructions on allocation of cash receipts between the two Medicare trust funds, (2) includes steps for ongoing updating of guidance, (3) articulates how the manual will be used and implemented, (4) uses the results of audit findings and oversight reviews to determine areas where more complete and detailed guidance to contractors is needed, and (5) reviews the contractor fiscal intermediary and carrier manuals to determine which sections need updating.

- Improve internal financial reporting processes by developing comprehensive policies and procedures that clearly define (1) the process to be followed in preparing the financial statements, (2) the routine accounting procedures performed by OFM, and (3) the number of staff and skills needed to carry out OFM accounting and financial reporting responsibilities.
- Develop a comprehensive financial management strategy that clearly (1) defines financial management objectives and goals, (2) specifies corrective actions to address financial management weaknesses, (3) includes target dates and resources necessary to implement corrective actions, (4) identifies offices/staff responsible for carrying out the corrective actions, (5) provides clear implementation plans that link the various financial management improvement initiatives currently underway and alternative plans in the event these reviews cannot be continued, (6) provides details on the systems architecture and requirements needed for its integrated financial management systems, and (7) includes a human capital needs assessment.

Agency Comments and Our Evaluation

In written comments (reprinted in appendix I) on a draft of this report, HHS and HCFA officials agreed with our recommendations and discussed steps that they have begun or are planning to take to address HCFA's financial management challenges. In their comments, HHS and HCFA officials reaffirmed their commitment to addressing the most serious deficiencies in HCFA's financial management system. They also provided technical comments, which we incorporated in this report as appropriate.

We agree with HHS and HCFA, as stated in their comments, that HCFA has taken a number of steps to improve the opinion on HCFA's financial statements and to address internal control weaknesses. However, many of the actions that HCFA cites in its comments as major strides toward addressing serious, longstanding financial management weaknesses are either still being developed or are not yet fully implemented. As a result, it is too soon to conclude whether these actions will be effective. For example, HCFA has hired independent certified public accounting firms to analyze the internal control systems of its largest Medicare contractors. When these reviews are completed, HCFA plans to use the results to ensure that contractors take corrective actions to resolve identified weaknesses. HCFA also plans to solicit external assistance next fiscal year to validate Medicare accounts receivable. Similarly, HCFA plans to require more specificity in contractor corrective action plans and is starting an agencywide workforce planning project. Until these initiatives have been fully implemented and evaluated, HCFA cannot ensure that it has resolved the underlying causes of its most serious audit findings as evidenced by persistent material internal control weaknesses cited in the audit report on HCFA's fiscal year 1999 financial statements.[22]

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should send your statement to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this report. A written statement must also be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of this report.

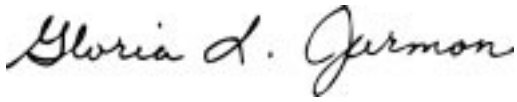
We are sending copies of this report to Senator Tom Harkin, Senator James Jeffords, Senator Edward Kennedy, Senator Joseph Lierberman, Senator Daniel Patrick Moynihan, Senator William Roth, Senator Arlen Specter, and Senator Fred Thompson and to Representative Bill Archer, Representative Dan Burton, Representative David Obey, Representative John Edward Porter, Representative Charles Rangel, and Representative Henry Waxman, in their capacities as Chairmen or Ranking Minority Members of Senate and House Committees and Subcommittees. We are also sending copies of this

[22]Health Care Financing Administration, *Fiscal Year 1999 Consolidated Financial Statements*, Ernst & Young LLP, February 2000.

report to the Honorable Donna Shalala, Secretary of Health and Human Services, and the Honorable Jacob J. Lew, Director of the Office of Management and Budget. Copies will be made available to others upon request.

Please contact me at (202) 512-4476 or by e-mail at *jarmong.aimd@gao.gov* if you have any questions about this report. Other GAO contacts and staff acknowledgments are listed in appendix IV.

Sincerely yours,



Gloria L. Jarmon
Director, Health, Education, and Human Services
Accounting and Financial Management

Comments From the Department of Health and Human Services

Note: GAO comments supplementing those in the report text appear at the end of this appendix. Technical comments are omitted.

DEPARTMENT OF HEALTH & HUMAN SERVICES

MAR 2 2000

Ms. Gloria L. Jarmon
Director
Accounting and Financial Management
General Accounting Office
441 G. Street, N. W.
Washington, D.C. 20548

Dear Ms. Jarmon:

The Department of Health and Human Services (HHS) and the Health Care Financing Administration (HCFA) have reviewed the General Accounting Office (GAO) draft report entitled, "Medicare Financial Management: Improvements Needed to Establish Financial Control and Accountability" (GAO/AIMD-00-66).

This report outlines many longstanding issues that we have taken aggressive actions to address. We are attacking financial management problems with the same focus and energy that we deployed to remediate, and test, our contractors' claims payment systems to meet the Year 2000 (Y2K) computer challenge. And we intend to be as successful in this area as we were in Y2K.

The findings of this report are similar to those that have been raised by us, working closely with the HHS Office of the Inspector General, and through contracts with independent Certified Public Accounting firms. As a result of our work, we have a more accurate picture of Medicare's financial status and a clearer understanding of the many actions we must take toward stronger financial management of the Medicare program. Indeed, an ambitious array of actions is already planned or underway, and these actions are consistent with the recommendations made in the GAO's report.

An indication of the progress we have made so far is our work toward an unqualified audit opinion of the HCFA financial statement. This has been the essential first step, assuring that Medicare's financial status is accurately portrayed, so that the most effective subsequent steps can be taken by us and our contractors toward sounder day-to-day financial management.

The financial control and accountability issues highlighted by the GAO in this report are not new; in fact, most of them have their roots in the system established in the 1965 Medicare law, whereby Medicare claims must be paid by private insurance companies at over 50 contractor sites around the country. Since the first audit of Medicare's 1996 financial statement, we have systematically worked to eliminate audit qualifications. With each year's audit, we have achieved substantial progress in improving internal controls.

We improved our audit opinion from a disclaimer in FY 1996 to a qualified opinion in FY 1997. By FY 1998, we had a single audit qualification. Between FY 1996 and FY 1998, we went from seven to three material weaknesses. These audit findings were resolved by setting a course of action in place over that two-year period and working diligently with the Office of the Inspector General to address the problems one by one. And we have taken actions this past year that we believe will help us achieve the next, and very significant, milestone: an unqualified opinion in the FY 1999 audit.

We know that an unqualified opinion does not mean our work is completed. Therefore, we have several strong actions underway and are developing further steps to modernize Medicare's accounting systems and strengthen oversight of the private claims-processing contractors.

See comment 1.

We will continue to address the most serious deficiencies in our financial management systems, and to demand proper documentation from our contractors. However, this report does not give appropriate emphasis to the fact that we have already made major strides in these areas. We have prioritized our major deficiencies, and are attacking each, one by one.

- In 1997, in response to the FY 1996 audit, we contracted with Ernst and Young to work with our Office of the Actuary to clean up our accounts payable. We have addressed concerns regarding Medicare accounts payable ledgers to the satisfaction of the external auditors. In addition, we funded an audit of the Social Security Administration process for withholding Supplemental Medical Insurance premiums that did not disclose any material weaknesses.

- In response to the FY 1997 audit, we were able to clarify our handling of cost reports and the Medicaid payables and receivables to the auditors' satisfaction, and we have made progress in each of the remaining areas of concern raised by the auditors.

- To strengthen contractor oversight, in 1998 we consolidated responsibility for contractor management within the Agency, establishing the new position of Deputy Director for Medicare Contractor Management within the Center for Beneficiary Services, and creating the Medicare Contractor Oversight Board to coordinate contractor-related activities.

- To address our accounts receivables issues, in 1999 we hired independent Certified Public Accounting firms to perform an extensive analysis of such receivables and validate more than 80 percent of the outstanding debt. These external experts were hired in consultation with the HHS Inspector General.

- To ensure consistency and focus on high risk areas, in 1999 we created standardized reporting and evaluation protocols and used national review teams to evaluate contractors' fraud and abuse efforts and other key functions. We are expanding these efforts this year.

- To address contractors' internal control systems, in 1999 we hired independent Certified Public Accounting firms to analyze 25 of the largest Medicare contractors, representing over 80 percent of Medicare fee-for-service payments. We will use the results to ensure that contractors take corrective action to resolve identified weaknesses.

- To ensure that corrective actions are taken, we have directed each claims-processing contractor to develop and implement Corrective Action Plans (CAPs) immediately to ensure that they can track funds more accurately. We have notified our contractors of our intent to amend our contracts with them (see Attachment I) to require details and time frames for correction of each deficiency. This will ensure specificity and completeness of the CAPs and enable us to measure performance in this area.

- To further strengthen and consolidate our financial controls and provide a focal point for our financial management efforts, in 1999 we created and filled a senior leadership position to coordinate the agency's business plans. The new Associate Director for CFO Audits and Internal Controls (Deputy Chief Financial Officer) has been charged with developing a comprehensive business plan that will define financial management objectives and goals for HCFA.

- We are also consolidating all accounting and Chief Financial Officer Act reporting functions in one organization along with establishing a new division to concentrate on internal controls and risk management. Ensuring procedure

guidelines and accounting policies are written, designated, and implemented is also part of the organizational focus.

- To prevent Medicare from paying claims that private insurance companies should pay, in 1999 we hired the first-ever national Medicare Integrity Program contractor. The contract will build on the roughly $3 billion Medicare already saves annually through its Medicare Secondary Payer initiatives.

- To more sharply focus our efforts, we are developing error rates to measure and track the payment accuracy for each claims-processing contractor, beginning this summer with the Durable Medical Equipment Regional Carriers. The results will guide contractors' plans to reduce errors, much as the Inspector General's national Medicare error rate has guided our improvement efforts.

- We are engaged in an agency-wide planning effort that will assess the staffing needs for financial management staffing as part of the baseline analysis. We also will consult with outside experts to help us develop financial analysis methodologies and other pattern analysis techniques, including staff skill building.

- We continue to seek contracting reform legislation to allow Medicare to hire from a larger pool of companies to process and pay claims. Existing law limits competition among, and our leverage with, these contractors by requiring Medicare to rely only on a shrinking pool of insurance companies and allowing some providers to choose their claims processor.

- Our long-term financial management strategy includes the development of an integrated financial management system to standardize the accounting systems used by all contractors. Until this system is operational, we will continue our short-term 'stop gap' corrective actions while simultaneously developing the new system.

See comment 1.

While much work remains, we have resolved the most serious audit findings and can now move on to the next level of financial management challenges. In completing your final report, we ask that you pay specific attention to our general and technical comments, so that the final report is accurate and balanced.

Page 5 – Ms. Gloria L. Jarmon

Thank you for your consideration of these comments and the opportunity to work with you to ensure that your report reflects our continued focus in the financial management of the Medicare program.

Sincerely,

John J. Callahan
Assistant Secretary for Management and Budget,
Chief Financial Officer
U.S. Department of Health and Human Services

Nancy-Ann Min DeParle
Administrator
Health Care Financing

Comments of the Health Care Financing Administration On the General Accounting Office Draft Report, "Medicare Financial Management: Improvements Needed to Establish Financial Control and Accountability"

GAO Recommendation 1

Improve procedures for evaluating and resolving findings from annual financial statements by developing, documenting, and implementing procedures so that managers promptly evaluate audit findings, determine proper actions in response to audit findings, and complete within established time frames all actions that resolve the findings brought to management's attention. In developing the procedures, coordinate with the central and regional office staff responsible for contractor oversight to ensure that resources are applied appropriately for timely follow-up with contractors on implementation of corrective actions to address CFO audit findings.

HCFA Comment

We agree and have already taken steps to address these issues. Audit resolution is a top priority at HCFA. Since fiscal year 1998, we have taken several steps to achieve these objectives. In fact, the Administrator has notified claims-processing contractors that we will amend each intermediary agreement and carrier contract to make correcting deficiencies identified during the annual CFO audit and other reviews a contractual requirement.

Procedures

See comment 2.

Each year as part of the CFO audits, the auditors perform reviews of approximately 10 contractors' financial management and internal controls. Since our fiscal year 1998 audit, HCFA has required that contractors develop Corrective Action Plans (CAPs) tailored toward resolving the deficiencies identified by auditors. We recognized that written procedures and more formal tracking processes would help strengthen our oversight of this area and in October 1999, we developed written procedures for requesting, tracking, and disseminating Medicare contractors' corrective action plans. The written procedures establish time frames for requesting, receiving, and evaluating CAPs submitted by the audited contractors. Each contractor's CAP must include a detailed description of each deficiency and specify the details of the action and time frames required to resolve the deficiency. In addition, we now require the contractors to submit quarterly reports on the status of their plans.

Using these procedures, we have already requested corrective action plans from all Medicare contractors that had audit findings in fiscal year 1999. For the eight contractors reviewed as part of the fiscal year 1999 CFO audit, we have received three CAPs and expect the remaining five to be submitted shortly. To enhance our evaluation of these plans, we are establishing a team of experts from within HCFA Central Office and

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Regional Offices to review each corrective action plan. The team will determine whether the proposed actions are adequate and will suggest alternative actions. HCFA will follow-up with the contractors to either approve or request revisions to their plan.

Coordination and Resources

Beginning in fiscal year 2001, we will include protocols to review contractor operations in the Contractor Performance Evaluation (CPE) process, to ensure that corrective action plans are effectively implemented. To ensure that regional offices are aware of this priority and are able to perform the reviews in the future, we recently held a conference with each of the 10 Assistant Regional Administrators responsible for financial management oversight at the contractors to discuss this priority. Realizing that interim steps are necessary, for fiscal year 2000, we will enter into a contract with a Certified Public Accounting firm to review all contractors' corrective actions to determine whether CFO audit findings identified since 1998 have been effectively resolved. This information will be incorporated as part of our CPE process.

Since establishing the position of Deputy Director for Contractor Management within the Center for Beneficiary Services (CBS) and consolidating responsibility for contractor management, we have been able to ensure that contractor oversight is aligned with the Agency's priorities. The Office of Financial Management (OFM) and CBS have coordinated closely on this issue to ensure that we are prepared to implement this contractor-wide effort in fiscal year 2001.

We also began strengthening the relationship between HCFA's Central Office and Regional Offices for the management oversight of the Medicare contractors. The 10 Regional Offices are organized into four consortia, and the Consortia Administrator provides leadership to the Regional Offices and coordinates regional activities. To improve both the accountability within the Regional Offices and strengthen the reporting relationship between the Regional Offices and Central Office, we are consolidating the leadership responsibility for the Regional Office management of contractors by establishing the position of Consortium Contractor Management Officer. Within each consortium, this individual will be accountable for the management of specific contractors. To ensure consolidation of responsibility for contractor activities and provide central office program direction, this individual will report to both the Deputy Director for Contractor Management and the Consortium Administrator. The Consortium Contractor Management Office will also oversee staff with primary responsibility for contractor management.

Furthermore, the fiscal year 2001 budget asks Congress for funds for contractors to hire their own staff specifically dedicated to implementing financial reporting internal controls, responding to audit findings reported by HCFA and the Office of the Inspector General, and correcting problems identified in the audits.

GAO Recommendation 2

Improve oversight of contractor financial activities by working with the central and regional office staff responsible for annual contractor performance evaluations to (1) refine and expand procedures for review of contractor financial activities, (2) leverage staff with the necessary skills to evaluate contractor financial activities, and (3) identify specific contractors and financial activities to be reviewed.

HCFA Comment

We agree, and for the past several years we have initiated strong steps to achieve these objectives. Strong contractor oversight is another top priority for HCFA. In February 2000, HCFA Central Office and Regional Offices financial managers met to lay out strategies to evaluate contractor financial activities. They discussed the need to identify resources and strategies to oversee financial activities. During fiscal year 2000 we will review financial reporting, medical review, and benefits integrity. Emphasis will be placed on contractor accounts receivable since that is the area that will require additional controls and oversight until the HCFA Integrated General Ledger Accounting System (HIGLAS) project is implemented.

Contractor Oversight

During 1999, the review of contractor accounts receivable was a required CPE review at all contractors. CPE reviewers used an accounts receivable review protocol drafted by HCFA's Office of Financial Management. In addition, as stated in the response to Recommendation 1, we entered into contracts with Certified Public Accounting firms to review contractor accounts receivable in order to validate receivable amounts reported to HCFA. The consultant review was conducted at 15 contractors, which comprised more than 80 percent of the accounts receivable balance. To ensure that we continue this important review of accounts receivable, we will enter into similar agreements during fiscal year 2000.

In addition, we contracted with Certified Public Accounting firms to conduct Statement of Auditing Standards (SAS-70) internal control reviews of 25 of our contractors which comprise more than 80 percent of Medicare fee-for-service expenditures. The SAS-70 reviews include an in-depth review of all contractor internal controls, and a validation test of all of the financial management internal controls. As part of this contract, we will create a financial management internal control manual to serve as the basis for future internal control reviews.

Furthermore, with the assistance of the Office of the Inspector General, we will develop contractor report cards that will measure how well individual contractors perform in financial management areas. The first report cards will be issued in 2001.

Resources

Resources are an important part of ensuring quality oversight of contractor operations. We have begun documenting both what resources are available and what resources are needed for effective contractor oversight. Working with the Office of Internal Customer Support (OICS), we have also initiated a short-term project to identify the staff in the regional offices currently involved with contractor management and oversight. We will use this information to organize staff activities from a coordinated national and consortium approach instead of a regional office perspective. Staffing information will also identify gap needs for future work force planning.

We also initiated a project to identify what resources are necessary for contractor oversight. As part of a Continuous Improvement Project, we are monitoring all the resources, including staff and travel, necessary for CPE. National review teams with standardized protocols require more resources. To conduct an on-site audit of a single business function at a contractor currently takes 3-5 staff working approximately 2 weeks. This time frame includes preparation, actual on-site review, and report completion.

To better identify specific contractors and financial activities to be reviewed, we developed and are using in fiscal year 2000 a documented risk assessment tool. Risk assessments of all Medicare contractors in 11 different functional areas were conducted for the fiscal year 2000 CPE process. We will use this information to direct CPE resources to specific contractors determined to be high risks. This tool will be refined to help us identify specific financing areas that need to be reviewed.

GAO Recommendation 3

Improve the agency's ability to detect irregular financial activities and identify high risk contractors by (1) developing analysis and risk assessment procedures that detect unusual variances, anomalies, and patterns in the amounts of funds withdrawn, funds expended, bank balances, accounts receivable, accounts payable, and other key financial data reported by contractors and (2) coordinating and sharing analysis and risk assessment methodologies with central and regional office staff responsible for contractor monitoring and oversight.

HCFA Comment

We strongly agree that we need to develop robust analytical methodologies and processes to better identify potential problems and quickly respond to them. HCFA receives and maintains both monthly and quarterly reports from each contractor describing their financial activities in areas such as accounts receivable, accounts payable, and funds drawn and expended. While we currently perform analysis of this data on a high-level,

aggregate basis, we recognize that we could do better. Therefore, we are hiring an outside consultant to assist us in developing the analytical tools necessary to perform routine trend analysis of critical financial data in an effort to identify unusual variances and potential areas of risk.

We will designate staff to work with the consultant. These staff will perform the (1) data analysis, (2) follow-up with contractors upon the identification of a potential problem, and (3) determine what further actions are necessary to ensure that the problem has been adequately resolved. Our plan is that by fiscal year 2001, HCFA will have established a financial analysis function. Once this function is established, the Deputy Director for Contractor Management will coordinate and share this information with both Central Office and Regional Office staff. Also, we will determine the best way to build on current risk assessment tools that have already been developed.

GAO Recommendation 4

Improve guidance to contractors for executing Medicare financial activities by ensuring that the current initiative to develop a comprehensive contractor financial manual (1) solicits input from contractors on the areas where better guidance is needed to address longstanding internal control weakness, such as specific instructions on allocations of cash receipts between the two Medicare trust funds, (2) includes steps for ongoing updating of guidance, (3) articulates how the manual will be used and implemented, (4) uses the results of audit findings and oversight reviews to determine areas where more complete and detailed guidance to contractors is needed, and (5) reviews the contractor fiscal intermediary and carrier manuals to determine which sections need updating.

HCFA Comment

We agree and, because this is a key HCFA initiative, have already initiated steps to address this issue. In September 1999, HCFA contracted with a consulting services firm for development of a financial management internal control manual. This manual will be primarily used by HCFA Central and Regional Office staff, and will provide standards for uniformly evaluating contractors' financial management performance. The consultant has already gathered data and interviewed Central Office staff on how to best evaluate contractors' financial management activities. Currently, they are obtaining similar information from HCFA's Regional Office staff, and will subsequently interview one contractor per region to gain contractor input.

In addition, the consultant will create a database that we will include on HCFA's Intranet and the Internet. This database will contain all financial management guidance and instructions that HCFA components have provided to contractors. In creating the database, our consultants will identify areas where HCFA's guidance may be deficient or require clarification. The database is scheduled for completion in September 2000.

As noted by GAO, contractor guidance related to trust fund allocations could be enhanced. In an effort to respond to GAO's concerns, HCFA will issue a Program

Memorandum shortly to contractors clarifying our instructions for allocating cash receipts between the two Medicare trust funds.

Updates to the Manual

Routine maintenance and upkeep of the manual will be important to ensure that Medicare contractors are knowledgeable of and consistently following HCFA's financial management policies. Therefore, HCFA will update and revise the manual on a yearly basis, incorporating the results from oversight activities, as well as other evaluation efforts. HCFA will also take into consideration the results of other reviews such as the CFO audit, Office of Inspector General (OIG) and GAO reviews. Also, HCFA will review the contractor fiscal intermediary and carrier manuals to identify all financial management related instructions and determine appropriate actions for updating these sections.

GAO Recommendation 5

Improve internal financial reporting process by developing comprehensive policies and procedures that clearly define (1) the process to be followed in preparing the financial statements, (2) the routine accounting procedures performed by OFM, and (3) the number of staff needed to carry out OFM accounting and financial reporting responsibilities.

HCFA Comment

HCFA agrees, and has designated financial reporting as an area for improvement in fiscal year 2000. In response to the CFO audit findings, we are currently working to improve our internal financial reporting processes, including enhancements to and expansion of existing financial reporting instructions. Also, we will hire outside consultants to further assist us in developing comprehensive written accounting procedures in accordance with federal accounting standards. As part of a recently initiated agency-wide workforce planning effort, we will assess financial management staffing needs. We will determine current and future workloads and skill gaps. Based on this assessment, we will make the necessary human resource proposals to ensure that staff are appropriately assigned and that there are an adequate number of staff to perform these accounting and other financial management related responsibilities.

GAO Recommendation 6

Develop a comprehensive financial management strategy that clearly (1) defines financial management objectives and goals, (2) specifies corrective actions to address financial management weaknesses, (3) includes target dates and resources necessary to implement corrective actions, (4) identifies offices/staff responsible for carrying out the corrective action, (5) provide clear implementation plans that link the various financial management improvement initiatives currently underway and alternative plans in the event these reviews cannot be continued, (6) provides details on the systems architecture and

requirements needed for its integrated financial management systems, and (7) includes a human capital needs assessment.

HCFA Comment

We agree that a comprehensive financial management business plan can serve as the cornerstone for resolving our remaining audit findings, as well as allow HCFA to better plan for the future. To begin this process, we recently established a Senior Executive Service position, Associate Director for CFO Audits and Internal Controls (Deputy CFO), within OFM. The Associate Director is currently developing a comprehensive financial management business plan that will identify the strategies that will achieve these objectives.

In the development of this plan we will consider the financial management objectives and goals that we currently have identified in the CFO annual Financial Management Status Report and 5-Year Plan, agency-wide strategic plans, annual performance plans as required by GPRA, and annual office work priorities. We also have the foundation in place that is addressing the system architecture and requirements needed for an integrated financial management system. This process is currently underway with the business requirements for an integrated general ledger system for the three standard claims-processing systems that all Medicare contractors will transition to, planned for completion by June 2000.

See comment 3.

In fiscal year 1999, HCFA initiated an agency-wide workforce planning project. This project consists of a four phase model: analyzing current and future work functions; developing current and future competency frameworks; identifying existing workforce competencies; and conducting an analysis of the gap between what is required and what we currently have. This process is being supplemented with retirement and retention analyses. The resulting workforce planning data will serve as the basis for tactical plans for recruitment, succession planning, learning and training, and staffing or redeployment. We anticipate having baseline workforce planning data available for inclusion in our fiscal year 2002 budget request. This time frame also enables us to use the information to formalize hiring, staffing, and learning plans for fiscal year 2001.

The following are GAO's comments on the Department of Health and Human Service's letter dated March 2, 2000.

GAO Comments

1. See "Agency Comments and Our Evaluation" section.

2. We have modified the report to reflect development of written procedures related to contractor corrective action plans.

3. We have modified the report to reflect this project.

Financial Management/Internal Control Weaknesses Included in Financial Statement Audits, Fiscal Years 1996-1999

	FY 1996	FY 1997	FY 1998	FY 1999
Finding: Weaknesses in contractors' ability to accurately report financial data due to insufficient accounting systems, inadequate independent verification of reported amounts, and lack of other financial controls. **Effect:** HCFA has limited assurance that amounts reported by contractors are properly classified, summarized, and supported by appropriate detailed records to ensure their validity.	•	•	•	•
Finding: HCFA preparation of annual financial statements is manually intensive, requiring extensive adjustments due to lack of an accounting software package to automatically manipulate data for development of financial statements. **Effect:** HCFA cannot timely prepare financial statements and material errors may not be detected timely.	•	•	•	•
Finding: HCFA lacked adequate procedures to detect errors in data used to estimate the entitlement benefits due and payable liability. **Effect:** The liability could be inaccurately reported in financial statements.	•	•	•	•
Finding: Contractor EDP controls over data processing systems do not provide adequate safeguards to reduce improper access to and manipulation of data. **Effect:** Confidential medical data may be disclosed and Medicare claims improperly processed or paid.	•	•	•	•
Finding: Contractor controls to properly account for cash balances and activity do not provide adequate safeguards to reduce the opportunities for theft and irregularities in cash procedures. **Effect:** Medicare funds could be misused.	•	•	•	•
Finding: HCFA lacked detailed records to support overpayments owed back to the Medicare program by providers and other entities when Medicare is the secondary payer of claims. **Effect:** Potential losses in collecting millions from accounts receivables that are deemed uncollectible due to lack of support.	•	•	•	•
Finding: HCFA lacked oversight and monitoring practices to ensure that material errors in contractor financial data are detected promptly. **Effect:** HCFA could not accurately and timely account for Medicare finances.	•	•	•	•

Source: GAO analysis of HHS OIG reports on the financial statement audits of the Health Care Financing Administration for fiscal years 1996-1999.

Financial Management Improvement Projects

Project name	Project phase	Project objective(s)	Current projected completion date
Integrated General Ledger Accounting System (IGLAS)	Development of system requirements	Develop an integrated general ledger accounting system at the contractor and HCFA levels.	After 2004
Recovery Management Accounting System (ReMAS)	Development of system requirements	Develop an integrated system to manage and account for the recovery of Medicare payments made in error because the beneficiary has other insurance (Medicare as the secondary payer, MSP).	July 2001 or later
Medicare Accounts Receivable System (MARS)	Development of system requirements	Design, develop, and implement a computer system which will receive accounts receivable data from the Medicare-contractor selected systems and, from this data, will produce information needed by HCFA staff in debt collection and financial reporting activities (non-MSP receivables).	July 2001
Internal Control Review (consolidation of HCFA's financial management guidance into one manual)	Identification of the current sources of financial management guidance (program memorandums, carrier/financial intermediary manuals)	Develop a manual that will be the one source for contractors regarding financial management requirements and instructions. A users' manual would also be written to be used by auditors/reviewers to assess contractor compliance with the guidance.	August 31, 2000
Medicare accounts receivable consulting efforts	Complete for FY 1999; similar effort planned for FY 2000	Validate the accuracy and completeness of Medicare contractors' accounts receivable balances at fiscal year-end and through the subsequent 6 months of activity.	Not yet finalized
SAS-70/Self-Certification Reviews	Funding has been approved for the performance of SAS-70/self-certification reviews at 26 Medicare contractors	To perform internal control reviews at selected Medicare contractors as part of HCFA's performance evaluation to ensure that these contractors meet their contractual obligations.	April 2000

Source: GAO analysis of documents and oral statements provided by HCFA staff.

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