

GAO

United States General Accounting Office

Report to the Secretary of Health and
Human Services

October 1993

MEDICARE

Better Guidance Is Needed to Preclude Inappropriate General and Administrative Charges



1. The first part of the document discusses the importance of maintaining accurate records of all transactions and activities. It emphasizes that this is crucial for ensuring transparency and accountability in the organization's operations.

2. The second part of the document outlines the various methods and tools used to collect and analyze data. It highlights the need for consistent and reliable data collection processes to ensure the validity of the findings.

3. The third part of the document describes the results of the data analysis and the key findings. It notes that the data indicates a significant trend in the market, which has implications for the organization's strategic planning.

4. The fourth part of the document discusses the implications of the findings and the recommendations for future actions. It suggests that the organization should focus on improving its internal processes and strengthening its relationships with key stakeholders.

5. The final part of the document provides a summary of the key points and concludes with a statement of the author's appreciation for the support and assistance provided throughout the project.



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-254711

October 15, 1993

The Honorable Donna E. Shalala
The Secretary of Health and
Human Services

Dear Madam Secretary:

On June 23, 1993, we testified before the Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, concerning the results of our review of the Hospital Corporation of America's (HCA) corporate general and administrative expenses for its fiscal year ended December 31, 1991 (see app. I). We focused our testimony on unallowable, questionable, and unsupported costs HCA included in its Medicare cost report. This letter summarizes the results of our testimony and makes a recommendation to you to strengthen the Medicare guidelines.

Results in Brief

We examined \$2.6 million of HCA's general and administrative expenses and identified \$1.1 million that we consider to be either unallowable, questionable, or unsupported. Of the \$1.1 million, we consider \$549,059 to be unallowable in accordance with Medicare cost principles, \$416,972 to be questionable because the relationship of the costs to patient care was not clear, and \$100,716 to be unsupported because the documentation was insufficient for us to determine the allowability of the costs. Including these costs in the Medicare cost report not only adds to the costs the government pays for Medicare, but also adds to the cost of health care in general.

HCA is not the only health care provider that has claimed unallowable or questionable costs in Medicare cost reports. The Department of Health and Human Services' (HHS) Inspector General recently completed reviews of general and administrative expenses and employee fringe benefit costs at 19 hospitals and 2 corporate offices located throughout the country. He found \$50 million in unallowable costs and over \$3 million in questionable costs included in the Medicare cost reports of these providers. In his review, he also noted that the lack of explicit guidance in Medicare cost principles was, at the very least, a contributing factor to unallowable and questionable costs being claimed.

In our opinion, the general nature of the Medicare cost principles was a major reason why HCA included unallowable and questionable costs in its

report. However, the manner in which HCA interpreted those cost principles also resulted in such costs being included.

Medicare's basic rule is that a cost must be reasonable, necessary, and related to patient care to be allowable. However, the cost principles implementing this rule are not specific enough. As a result, health care providers have considerable latitude in deciding whether to include particular cost items in their Medicare cost reports.

Medicare cost principles, for example, do not specifically address many of the costs we consider to be unallowable, such as alcoholic beverages, entertainment, and scholarships for employee dependents. Furthermore, they do not address many of the costs we consider to be questionable, such as gifts, flowers, awards, and functions such as Christmas parties for employees. Our review showed that HCA included these type costs in their Medicare Cost Report.

While not applicable to Medicare cost determinations, the Federal Acquisition Regulation¹ (FAR) and Office of Management and Budget (OMB) Circular A-21² provide comparable guidance concerning the allowability of some of the types of general and administrative expenses we considered unallowable or questionable at HCA. Both the FAR and OMB Circular A-21, for example, provide that costs for alcoholic beverages and entertainment are unallowable charges to the government, whereas Medicare cost principles do not specifically address either of these costs. Table 1 illustrates the allowability of selected expenses under the Medicare, FAR, and OMB A-21 cost principles.

¹The FAR contains uniform policies and procedures for the procurement of supplies and services by federal executive agencies and includes cost principles governing the allowability of general and administrative expenses under government contracts with commercial concerns.

²OMB Circular A-21 establishes cost principles that educational institutions are required to follow in determining the types of allowable costs and the methods of allocating such costs to federally funded research contracts.

Table 1: Comparison of Allowability of Selected Expenses Under Medicare, FAR, and OMB A-21 Cost Principles

Expense	Medicare	FAR	OMB Circular A-21
Alcoholic beverages	Not specifically mentioned	Unallowable	Unallowable
Entertainment	Not specifically mentioned	Unallowable	Unallowable
Contributions	Not specifically mentioned	Unallowable	Unallowable
Scholarships for dependents	Not specifically mentioned	Unallowable	Allowable ^a
Memberships in civic organizations	Allowable	Unallowable	Unallowable
Subsidized food costs	Allowable ^b	Unallowable ^c	Unallowable ^c
Advertising ^d	Unallowable	Unallowable	Unallowable

^aWe are reviewing the basis for reimbursing educational institutions for scholarships and related expenses for employee dependents to determine if such expenditures are warranted under government research contracts.

^bReasonable unrecovered costs of a provider's personnel meals are allowable when deemed an employee fringe benefit related to patient care.

^cSubsidized food costs are unallowable unless the contractor's or educational institution's objective is to operate the food service on a break-even basis.

^dAdvertising costs to promote the sale of goods or services are generally unallowable.

We discussed the results of our review with Health Care Financing Administration (HCFA) officials from its Bureaus of Policy Development and Program Operations. The Director, Office of Payment Policy, said he considered most of the expenses we questioned to be allowable for reimbursement as employee fringe benefits under the Medicare program. He pointed out the real issue was the reasonableness of the total compensation to the employee. If the compensation is reasonable, he said the individual cost items we identified were not so important. He also said that expenditures for items such as alcoholic beverages and entertainment were common in the health care industry and were used to attract and retain employees. Thus, he considered such expenditures to be related to patient care.

The HCA expenses we considered to be unallowable were either expressly unallowable under Medicare cost principles or, in our opinion, were not proper, necessary, or related to the care of Medicare patients. We observed that the Administrator, HCFA, in October 1991, reached the same conclusion on certain expenses when he disallowed the costs of alcoholic

beverages and football tickets. He considered these costs to be unnecessary and not related to patient care. In addition to the unallowable costs discussed in our testimony, the relationship of the questionable expenses to patient care was not clear and, at best, had only a marginal relationship.

Recommendation

Because the type of expenses we discussed in our testimony increase the cost of the Medicare program, as well as increase health care costs in general, we believe that specific Medicare guidance is needed on the allowability of general and administrative expenses, especially expenses such as alcoholic beverages and entertainment. Therefore, we recommend that you direct the Administrator, HCFA, to revise the Medicare cost principles for general and administrative expenses to make them more specific, consistent with the basic Medicare cost rule that a cost must be reasonable, necessary, and related to patient care to be allowable. We believe the cost principles contained in the FAR and OMB Circular A-21 should be used as a guide regarding the allowability of general and administrative expenses.

Scope and Methodology

We examined \$2.6 million of HCA's corporate general and administrative expenses for its fiscal year ended December 31, 1991. Our objectives were to (1) determine if HCA included unallowable costs in its Medicare cost report and (2) identify the amount and nature of costs HCA excluded.

To determine the allowability of general and administrative expenses, we used Medicare cost principles contained in Medicare regulations and HCFA's Provider Reimbursement Manual, which contains guidelines and procedures for implementing Medicare regulations. When the regulations and manuals did not discuss a specific activity or provided only general guidance on the allowability of a particular cost item, we applied the basic Medicare cost principle—an expense must be necessary, reasonable, and related to patient care to be allowable.

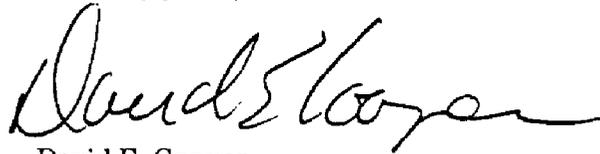
We also considered cost allowability decisions made by the Provider Reimbursement Review Board and the HCFA Administrator. The Board reviews appeals from health care providers who disagree with their intermediaries on the allowability of questioned costs. While the FAR and OMB Circular A-21 are not applicable to Medicare cost determinations, we looked at how they address some of the types of expenses HCA included in its cost report.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of the actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

We are sending copies of this letter to the Director, Office of Management and Budget, and interested congressional committees. Copies will also be made available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this letter. Other major contributors to this letter and the related testimony are shown in appendix II.

Sincerely yours,

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

David E. Cooper
Director, Acquisition Policy, Technology,
and Competitiveness Issues

Testimony

GAO

United States General Accounting Office

Testimony

Before the Subcommittee on Oversight
and Investigations, Committee on Energy and Commerce,
House of Representatives

For Release
On Delivery
Expected at
10:00 a.m., EDT,
Wednesday,
June 23, 1993

OVERHEAD COSTS

Unallowable and Questionable Costs Charged to Medicare by Hospital Corporation of America

Statement of Neal P. Curtin, Director for Reporting, National
Security and International Affairs Division



GAO/T-NSIAD-93-16

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to appear before you today to discuss the preliminary results of our review of the Hospital Corporation of America's (HCA) corporate general and administrative expenses for its fiscal year ended December 31, 1991.¹ As you are aware, we have undertaken a number of assignments at your request and at the request of other committees to examine the extent to which unallowable costs are passed on to the government. In response to your specific request on HCA, we are reviewing corporate general and administrative expenses to (1) determine if HCA included unallowable costs in its Medicare cost report and (2) identify the amount and nature of costs HCA excluded.

Results in Brief

We examined \$2.6 million of HCA's general and administrative expenses and identified \$1.1 million, which we consider to be either unallowable, questionable, or unsupported. We believe the general nature of the Medicare cost principles was the primary reason for HCA including unallowable and questionable costs in its Medicare cost report. The manner in which HCA interpreted the cost principles also contributed to unallowable and questionable costs being included in the report.

Of the \$1.1 million, we considered \$549,059 to be unallowable in accordance with Medicare cost principles, \$416,972 to be questionable because the relationship of these costs to patient care was not clear, and \$100,716 to be unsupported because the documentation was insufficient for us to determine the allowability of the costs. HCA estimates it received cost reimbursement from Medicare for about 3 percent of the costs it included in the Medicare cost report. While we are still evaluating information HCA provided on some of these costs, we do not expect any material change in our findings or overall conclusions.

HCA excluded net costs of \$431.7 million from its Medicare cost report. However, HCA allocated these costs to its hospitals, which added to the cost of health care at these facilities.

HCA is not the only health care provider that has included unallowable or questionable costs in Medicare cost reports. As you know, the Department of Health and Human Services' Inspector General (IG) recently completed reviews of general and administrative expenses and employee fringe

¹Corporate general and administrative expenses are the home office costs of running a hospital chain and include expenditures for such items as travel, office supplies, accounting services, and legal expenses.

benefit costs at 19 hospitals and two corporate offices located throughout the country. The IG identified \$50 million in unallowable costs and over \$3 million in questionable costs included in their Medicare cost reports. In several of its reports, the IG expressed concern that such costs increased the cost of health care in general and Medicare specifically. We agree.

Background

The Medicare program, authorized by title XVIII of the Social Security Act, helps pay medical costs for people age 65 years and older and certain individuals with disabilities. Medicare is administered by the Health Care Financing Administration (HCFA), within the Department of Health and Human Services. Medicare costs represent the fourth largest category of federal expenditures after defense, social security, and interest payments on the national debt.

HCA is a large hospital management company headquartered in Nashville, Tennessee. For its fiscal year ended December 31, 1991, HCA had net operating revenues of \$5 billion and net income of \$34 million. At that time, the Corporation owned and operated 74 medical and surgical hospitals and 54 psychiatric hospitals.

HCA incurred a net of \$545.9 million in corporate general and administrative expenses for 1991. Of this amount, HCA included \$114.2 million in its home office Medicare cost report.² HCA excluded the remaining \$431.7 million from the report because it either considered the costs unallowable or because the intermediary had previously disallowed the costs. Of the amount excluded, \$345.3 million was for employee stock options, which Blue Cross and Blue Shield considered to be excessive and unreasonable employee compensation. HCA also excluded certain charitable contributions, part of its interest and depreciation expense, marketing and promotional costs, and various other costs.

Through its home office cost report, HCA allocated the \$114.2 million to its hospitals, and the hospitals, in turn, included the costs in their cost reports. Besides allocating general and administrative costs to its hospitals through the home office cost report, HCA also directly assigns certain costs to its hospitals for inclusion in their cost reports.

²Blue Cross and Blue Shield of Tennessee, referred to as an intermediary, is responsible for auditing HCA's home office Medicare cost reports. Blue Cross and Blue Shield has not completed its audit of HCA's 1991 report.

In reviewing the expenses HCA included in its corporate Medicare cost report, we concentrated on those expenses we believed had the highest potential for containing unallowable costs.

Criteria Used in Reviewing HCA Expenses

To determine the allowability of general and administrative expenses, we used Medicare cost principles contained in Medicare regulations and HCFA's Provider Reimbursement Manual, which contains guidelines and procedures for implementing Medicare regulations. The basic rule behind Medicare's cost principles is that a cost must be reasonable, necessary, and related to patient care to be allowable.

Although Medicare's regulations and manuals cover many specific types of costs and situations, they do not cover all possible costs and situations. Thus, health care providers have a considerable latitude in deciding whether to include a cost item in their cost reports. When the regulations and manuals did not discuss a specific activity or provided only general guidance on the allowability of a particular cost item, we applied the basic Medicare cost principle—an expense must be necessary, reasonable, and related to patient care to be allowable.

We also considered cost allowability decisions made by the Provider Reimbursement Review Board and the HCFA Administrator. The Board reviews appeals from health care providers who disagree with their intermediaries on the allowability of questioned costs. The HCFA Administrator can either accept, modify, or overturn the Board's decisions. Although both decisions are binding only on the provider for which the decision was made, we used the decisions as an additional factor in deciding the allowability of HCA's general and administrative expenses.

While the Federal Acquisition Regulation is not applicable to Medicare cost determinations, we looked at how the regulation addresses some of the types of expenses HCA included in its cost report. The regulation contains uniform policies and procedures for the procurement of supplies and services by federal executive agencies and includes cost principles governing the allowability of general and administrative expenses under government contracts.

Costs Allocated to Medicare

Mr. Chairman, I would first like to discuss the results of our work on the costs that HCA included in its Medicare cost report, and later in my

testimony, address the costs HCA excluded from its report. Although the former impacts the costs that the government pays for Medicare, both impact the costs of health care in general.

Unallowable Costs

We identified expenditures of \$549,059, which we believe are unallowable. Following are examples of these expenditures:

Alcoholic Beverages

We identified \$17,755 in expenditures for alcoholic beverages at various employee meetings and functions.³ For example, we noted HCA spent \$3,053 for a dinner cruise for its chief financial officers at Opryland USA on March 13, 1991. Of this amount, \$531 was for alcoholic beverages.

Alcoholic beverages, in our opinion, are not related to patient care and, therefore, should be unallowable. Although Medicare cost principles do not specifically discuss alcoholic beverages, the HCFA Administrator, in October 1991, disallowed alcoholic beverage costs at a hospital because they were unnecessary and not related to patient care. Furthermore, the Federal Acquisition Regulation expressly disallows alcoholic beverages as a charge against government contracts.

Entertainment

We identified expenditures of \$51,013 for entertainment at employee meetings and other functions.⁴ This included \$24,849 for entertainment at a meeting held on July 24-26, 1991, at Hilton Head Island, South Carolina, attended by employees and their spouses and children. Entertainment expenditures for this meeting included \$14,225 for a theme party, \$3,500 for a singing group, \$2,000 for a "Saturday Night Live" entertainment video, \$1,953 for team competition events, \$1,710 for a sailing regatta, and \$1,461 for children entertainment programs.

HCA spent an additional \$11,641 to subsidize employee tickets to the symphony, theater, and ballet, and made other expenditures totaling \$14,523 for such items as a disc jockey, musicians, and clowns to entertain at employee functions; golf at a Chief Executive Officer's conference; a reception at a local comedy showplace; and a river dinner cruise.

While Medicare cost principles do not specifically discuss these types of entertainment costs, such costs, in our opinion, are not related to patient

³HCA included \$12,113 of this amount in its Medicare cost report and assigned the remaining \$5,642 directly to its hospitals.

⁴HCA included \$27,721 of this amount in its Medicare cost report and assigned the remaining \$23,292 directly to its hospitals.

care and, therefore, are unallowable. In this regard, the HCFA Administrator, in October 1991, disallowed a hospital's entertainment costs (football tickets) on the basis that they were unnecessary and not related to patient care.

The Federal Acquisition Regulation expressly disallows expenditures for social activities and tickets to sporting events and shows, as a charge to government contracts.

Marketing and Promotional Activities

We found expenditures of \$52,601 for marketing and promotional activities, which we believe are unallowable. Medicare cost principles prohibit reimbursement for advertising costs directed toward increasing the number of patients at a provider's facilities.

HCA included \$26,248 in its Medicare cost report for expenses designed to counteract negative publicity resulting from an investigation by Texas authorities into the practices of certain psychiatric hospitals.⁵ These costs included \$24,308 for a public relations firm to carry out a media relations program designed to counteract negative publicity generated by the investigation.⁶ The remaining \$1,940 was for a meeting in Orlando, Florida, between HCA and the public relations firm to plan how to counter the adverse publicity if it impacted HCA's psychiatric hospitals located in Florida.

While these expenditures did not involve direct advertising to the general public in newspapers and through television and radio, we believe their purpose was the same—to influence the number of patients admitted to HCA psychiatric hospitals—and are therefore unallowable.

HCA also spent \$16,419 for a local market analysis, \$2,849 for a presentation entitled A Practical Approach to Sales Management, and \$7,085 for other marketing and promotional activities which, in our opinion, were directed toward increasing the number of patients at HCA hospitals and therefore are unallowable.

⁵Texas authorities initiated an investigation in 1991 into charges that psychiatric hospitals had inflated bills for medications and services, billed customers for services never rendered, diagnosed and altered treatments to match insurance coverage, admitted patients who did not require hospitalization, and paid physicians and others for referring patients to hospitals. As a result of the investigation, several hospitals were required to follow specified policies and procedures.

⁶Of the \$34,725 paid to this firm, HCA claimed \$24,308 in its Medicare Cost Report, but excluded the remaining \$10,417 as unallowable costs.

Scholarships

HCA claimed \$233,547 for scholarships and related expenses for children of HCA employees. Medicare cost principles do not specifically discuss expenditures for scholarships; however, these expenses, in our opinion, are not related to patient care and are therefore unallowable. The Federal Acquisition Regulation expressly disallows such charges against government contracts with commercial organizations.

Professional Services

HCA claimed \$78,391 for professional services we believe are unallowable under the Medicare program. This includes \$65,026 for researching the tax consequences to HCA and its preferred stockholders of an exchange of preferred stock for debentures and printing and mailing quarterly dividend and tax information letters. Medicare cost principles provide that expenditures related to stockholders interests are unallowable.

HCA also claimed \$11,100 for services in connection with the sale of an HCA-owned ambulance company.⁷ This expenditure is unallowable under Medicare cost principles.

In addition, we found HCA claimed \$2,265 for tax services for non-hospital properties and aerial photographs of a joint venture condominium project. These costs are not related to patient care and are, therefore, unallowable.

Expenses for Non-HCA Employees

We identified expenditures of \$27,826 for non-HCA employees—mostly for food and beverages for employee spouses and children attending company meetings and other functions.⁸ According to Medicare cost principles, the cost of meals for non-HCA employees are unallowable on the basis that such costs are not related to patient care.

Foreign Travel

HCA claimed \$53,657 in travel costs to Italy, Belgium, and Australia related to its international health care facilities.⁹ We consider these travel expenditures to be unallowable because HCA incurred the costs in connection with the sale of foreign hospitals, which do not generally serve Medicare patients.

⁷Of the \$13,059 paid for these services, HCA claimed \$11,100 in the Medicare cost report but excluded the remaining \$1,959 as unallowable costs.

⁸HCA included \$26,893 of this amount in its Medicare cost report and assigned the remaining \$933 directly to its hospitals.

⁹Of the \$57,887 we identified in foreign travel expenditures, HCA included \$53,657 in the Medicare cost report and excluded the remaining \$4,230 as unallowable costs.

Sponsorships, Donations, and
Related Expenses

HCA claimed \$16,932 in expenditures for sponsorships, donations, and related expenses, which we believe are unallowable because they are not related to patient care. These expenditures include

- \$12,800 to sponsor students in a leadership program,¹⁰
- \$1,803 in donated art for a fund-raising event to benefit a non-HCA hospital,
- \$1,291 to an elementary school under an adopt-a-school program, and
- \$1,038 for other contributions and donations.

The Provider Reimbursement Review Board concluded as early as February 1976 that payments made to civic and charitable organizations were not reimbursable under Medicare because such payments were not related to patient care. The Board observed that health care providers, as community institutions, had civic responsibilities but pointed out that the Medicare program was not designed to share in these costs. Under the Federal Acquisition Regulation, these type costs are also unallowable as a charge against government contracts.

Other Expenditures

We found an additional \$17,337 that should not have been included in the Medicare cost report. Of this amount, HCA included \$10,402 because of an error in computing adjustments to its Medicare cost report,¹¹ and the remaining \$6,935 was for unallowable costs. The unallowable costs included expenditures for corporate restructuring activities; memberships in social, fraternal, and other organizations; abandoned acquisition planning; lobbying activities; and travel costs to attend a meeting not related to patient care.

Questionable Charges

In addition to unallowable costs, we identified \$416,972 in charges we considered questionable because the relationship of the expenses to patient care was not clear. Specifics of these expenses are discussed below.

Dues and Subscriptions

We identified claims of \$53,553 for membership dues, subscriptions, and publications which, in our opinion, have a questionable relationship to patient care. This amount includes \$16,500 for sponsorship of a strategic planning service; \$14,000 for memberships in the Better Business Bureau

¹⁰This program, known as INROADS, is designed to develop and place talented minority youth in business and industry and prepare them for corporate and community leadership.

¹¹In addition to this error, HCA made an erroneous adjustment for miscellaneous expenses that overstated the Medicare cost report by \$85,986. After we completed our review, HCA advised us of another error in miscellaneous expenses that understated the Medicare cost report by \$129,101. The net effect of these two errors is a \$43,115 understatement of costs claimed in the Medicare cost report.

and the Chamber of Commerce; \$8,000 for participation in a Conference Board (network of senior executives who provide business information); \$5,349 for airline guide publications even though HCA has its own dedicated travel agency; \$4,000 for membership in the Business Council (voluntary association of American business leaders who exchange ideas); and \$5,704 for other dues, memberships, and publications.

Awards, Plaques, and Gifts

We noted expenditures of \$97,631 for awards, plaques, and gifts.¹² These expenditures included \$52,487 for employee Christmas gifts (\$37,575 in gift certificates for corporate employees and \$14,912 for Tiffany pitchers for hospital executives), \$28,697 for the Frist Humanitarian Award (recognizes two individuals with a monetary award, a bronze statuette, and an all-expense paid weekend in Nashville, Tennessee), and \$16,447 for other employee awards, plaques, and gifts. The relationship of these items to patient care, in our opinion, is questionable.

Employee Functions

We identified \$26,387 in expenditures for employee functions that appear to have questionable benefit to patient care. HCA spent \$14,238 for a picnic; \$2,821 for a Christmas breakfast; \$1,854 for employee softball team uniforms and related expenses; \$1,396 for participation in a corporate sporting event; \$1,011 for an employee photo contest; and \$5,067 for other functions such as an employee Easter egg hunt, Halloween party, St. Patrick's day celebration, and a Valentine day luncheon.

Subsidized Food Costs

HCA spent \$137,359 to subsidize the cost of meals in its corporate cafeteria and to provide free beverages (coffee, tea, and hot chocolate) and snacks to employees. Again, the relationship of these costs to patient care is not clear. Furthermore, such costs would be unallowable against a government contract because losses from food services cannot be claimed unless the contractor's objective is to operate the services on a break-even basis.

Other Questionable Costs

We identified other expenditures totaling \$102,041 that are questionable to patient care. These include \$91,417 for art depreciation; \$3,671 for art appraisal fees and other expenses; \$2,460 for flowers for employees, their families, and others; \$2,419 for a reception at a Chief Executive Officer's conference; \$1,847 for film, photography, and framing; and \$227 for miscellaneous items.

¹²HCA included \$97,298 of these costs in its Medicare Cost Report, and assigned \$333 directly to its hospitals.

Unsupported Costs

We were unable to determine whether expenditures totaling \$100,716 were allowable based on available documentation. Most of this amount was for services purchased from a public relations firm. Based on the invoices submitted by the public relations firm, the services appear to include costs, which, in our opinion, are unallowable or questionable. However, the invoices did not contain sufficient information for us to accurately allocate expenditures between allowable, unallowable, and questionable costs.

Medicare cost principles require providers to maintain adequate records for proper determination of costs payable under the program. They further provide that the cost records must be adequate for verification by auditors. HCA records did not meet this requirement.

Cost Not Allocated to Medicare

In this part of my testimony, Mr. Chairman, I will address your second area of interest concerning the amount and nature of costs HCA excluded from its Medicare cost report. As discussed earlier, HCA excluded a net of \$431.7 million from its 1991 Medicare cost report because it either considered the costs unallowable or because the intermediary had previously disallowed the costs. Although these costs were excluded from the Medicare cost report, they were allocated to HCA's hospitals and, thus, increased the cost of providing health care to the general public. These unallowable costs equaled about 8 percent of HCA's consolidated expenses for 1991.

Employee Stock Option Compensation

HCA initially excluded \$345.3 million in employee stock option compensation from the 1991 Medicare cost report based on a determination by its intermediary, Blue Cross and Blue Shield. An intermediary representative told us that the compensation was excessive and unreasonable when compared to the compensation of similar employees in the health care industry. After submitting its 1991 Medicare cost report, HCA excluded an additional \$5.9 million for employee stock option compensation based on the intermediary's 1990 audit results, which were not available when the 1991 report was submitted.

Interest Expense

HCA excluded about \$95 million in unallowable interest expense from the 1991 Medicare cost report. Of this amount, about \$74 million was related to the Corporation's 1989 management-led, leveraged buyout and the

remaining \$21 million was related to other unallowable interest expense, such as accrued interest on disputed federal income tax.¹³

HCA incurred an additional \$233 million in interest expense during 1991 in connection with the leveraged buyout and assigned the expense directly to its hospitals. HCA advised us that interest expense applicable to the leveraged buyout was not included in the Medicare cost reports for its hospitals. We did not review the reports of individual hospitals to verify that the interest costs were excluded because we limited our review to the corporate Medicare cost report.

Depreciation Expense

HCA excluded \$1.6 million in unallowable depreciation from its Medicare cost report. Most of the exclusion was to adjust depreciation to comply with Medicare requirements and to exclude depreciation applicable to non-HCA tenants. The exclusion also included \$318,377 in depreciation applicable to the leveraged buyout.

HCA incurred and assigned an additional \$11.5 million in depreciation applicable to the leveraged buyout directly to its hospitals. HCA advised us that depreciation for the leveraged buyout was not included in the Medicare cost reports of its hospitals. We did not verify that the depreciation costs were excluded from the hospitals' Medicare cost reports.

Other Costs Excluded

HCA also excluded \$7.2 million of other unallowable costs from the corporate Medicare cost report, of which \$7 million was for a donation of stock options to a charitable foundation. The remaining costs consisted of smaller adjustments for unallowable marketing and promotional activities, lobbying expenses, and key man life insurance. After we started our review, HCA notified the intermediary that it was excluding an additional \$319,848 for marketing and promotional expenses.

Having talked a lot about our specific findings at HCA, let me add some brief perspective about other health care providers and then offer some further comments on Medicare cost principles.

¹³A leveraged buyout is a transaction accomplished when a small group of investors acquires a company financed largely by borrowing secured by the assets of the company.

Unallowable and Questionable Costs at Other Health Care Providers

The Department of Health and Human Service's IG recently completed reviews of general and administrative expenses and employee fringe benefit costs showed that health care providers routinely included unallowable and questionable costs in their Medicare cost reports.

At 21 facilities, the IG identified over \$50 million as unallowable costs in the Medicare cost reports, including expenditures for alcoholic beverages, entertainment activities, marketing and promotional costs, expenses paid for non-provider employees, and contributions to civic and charitable organizations.

The IG also identified over \$3 million in costs that were of questionable benefit to patient care. Many of the expenditures benefited employees, including picnics, gifts, flowers, Christmas parties, awards and recognition programs, and other related activities. While costs similar to these have been historically allowed by intermediaries and the Provider Reimbursement Review Board, the IG expressed concern in several reports that such costs increased the price of health care in general and Medicare specifically.

Medicare Cost Principles Are General

Medicare cost principles for determining the allowability of many general and administrative expenses—especially those incurred by a home office—are general in nature and do not specifically cover every type of cost and situation. When the cost principles do not discuss the allowability of a certain expense, the basic rule that a cost must be reasonable, necessary, and related to patient care has to be applied in deciding the allowability of the cost. In cases where the cost principles do address certain expenses, they lack sufficient clarity, in some instances, to ensure consistent and appropriate application by health care providers.

As a result, the cost principles are interpreted differently for many general and administrative expenses. In fact, the IG's audit staffs differed on whether an expenditure was unallowable or a cost for concern. In the area of entertainment, for example, some audit staffs considered football, baseball, movie, and symphony tickets as unallowable because such expenditures were not related to patient care. Other audit staffs did not disallow such costs, but expressed concern over their questionable nature. The IG staffs also differed on the classification of other expenditures, including employee sporting events, flowers, gifts for employees, promotional items, spouse travel and related costs, and employee meals.

Hospitals also have disparate views on how to treat various expenses. Some hospitals, for example, agreed that alcoholic beverages were unallowable under Medicare, but other hospitals considered alcoholic beverages to be allowable. Similar differences of opinion existed for such expenditures as entertainment activities, flowers, gifts, spouse travel, fines, penalties and settlements, advertising and public relations costs, contributions to charitable and civic organizations, memberships in social organizations, lobbying costs, and fund raising activities.

We believe the different interpretations applied to similar costs is attributable to the fact that the cost principles do not specifically discuss or contain guidance for some of the more controversial expenses such as alcoholic beverages, entertainment activities, and employee functions. Health care providers, therefore, have the latitude to decide whether expenditures for such items are reasonable, necessary, and related to patient care when preparing their cost reports.

There is a need, in our opinion, for additional guidance on how to treat the general and administrative expenses I have discussed today in Medicare cost reports.

Mr. Chairman, this concludes my testimony. I will be glad to address any questions you or the Subcommittee members may have.

**Appendix I
Testimony**

Table I.1: Summary of Unallowable, Questionable, and Unsupported Costs

Item	Unallowable	Questionable	Unsupported
Alcoholic beverages	\$ 17,755		
Entertainment	51,013		
Marketing and promotional activities	52,601		
Professional services	78,391		
Expenses for non-HCA employees	27,826		
Foreign travel	53,657		
Sponsorships, donations, and related expenses	16,932		
Other expenditures	17,337		
Scholarships	233,547		
Dues and subscriptions		\$53,553	
Awards, plaques, and gifts		97,631	
Employee functions		26,387	
Subsidized food costs		137,359	
Other costs for concern		102,041	
Unsupported			\$100,716
Total	\$549,059	\$ 416,972^a	\$100,716
Grand Total		\$1,066,747	

^aDoes not add because of rounding

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