I. Audit Approach

As an element of the University’s core business functions, the Medicare Cost Report will be audited once every three to five years using a risk-based approach. The minimum requirements set forth in the “general overview and risk assessment” section below must be completed for the audit to qualify for core audit coverage. Following completion of the general overview and risk assessment, the auditor will use professional judgment to select specific areas for additional focus and audit testing.

II. General Overview and Risk Assessment (Estimated time to complete – 100 hours)

At a minimum, general overview procedures will include interviews of department management and key personnel within the hospital’s financial services department; evaluation of policies and procedures associated with business processes; inventory of compliance requirements; consideration of key operational aspects; and an assessment of the information systems environment. During the general overview, a detailed understanding of the management structure, significant financial and operational processes, compliance requirements, and information systems will be obtained (or updated).

A. The following table summarizes audit objectives and corresponding high-level risks to be considered during the general overview.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Areas of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obtain a detailed understanding of significant processes and practices employed in preparing the cost report by specifically addressing the following components:</td>
<td>• Non-compliance with Center for Medicare and Medicaid Services (CMS) may subject the University to financial loss or federal government action.</td>
</tr>
<tr>
<td>• Management philosophy, operating style, and risk assessment practices</td>
<td>• Poor communication regarding expectations may result in inaccurate preparation of the report or inappropriate behavior.</td>
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<tr>
<td>• Organizational structure, and delegations of authority and responsibility</td>
<td>• Inadequate training may result in inaccurate preparation of the report.</td>
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<tr>
<td>• Positions of accountability for financial and programmatic results</td>
<td>• High-risk aspects of the report may not be identified and appropriately addressed by management.</td>
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<tr>
<td>• Compliance with external regulations and internal policy</td>
<td>• Poor review and oversight in the preparation of the cost report may result inaccuracies.</td>
</tr>
<tr>
<td>• Training of key personnel</td>
<td>• Inadequate accountability for the achievement of objectives may decrease the likelihood of achieving results.</td>
</tr>
<tr>
<td>• Process strengths (best practices), weaknesses, and mitigating controls</td>
<td></td>
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<tr>
<td>• Information systems, applications, databases, and electronic</td>
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</tbody>
</table>
B. The following procedures will be completed as part of the general overview whenever the core audit is conducted.

General Control Environment

1. Interview management and key personnel within hospital’s financial services department, and cost reimbursement office to identify and assess their philosophy and operating style, regular channels of communication, and all internal risk assessment processes relating to preparation of the cost report. Solicit input on concerns or areas of perceived risk.

2. Obtain reports from external reviews performed on the cost report or the process of preparing the cost report. Obtain copy of last audited cost report and determine whether anything unusual occurred (e.g., issues affecting the cost report from the Balanced Budget Act of 1997 were not incorporated into the cost report software and resulted in addenda being submitted).

3. Review the results of the last audit of the hospital’s cost report and determine if there were any adjustments and disallowed items. If there were adjustments/disallowed items, research the reason why the adjustment was made and whether this would be an issue in future cost reports.

4. Obtain pertinent organizational charts, delegations of authority, and management reports.

5. Interview select management and staff to obtain their perspective on the control environment. Solicit input on concerns or areas of perceived risk.

6. Evaluate the adequacy of the organizational structure and various reporting processes to provide reasonable assurance that accountability for the cost report is demonstrated. Determine if cross training of staff has occurred to assure timely and accurate completion of the cost report.

7. If the organizational structure and various reporting processes do not appear adequate, explore alternative structures or reporting processes to enhance assurance. Comparison to corresponding departments on other campuses may provide value.

8. Determine if the hospital has performed a risk assessment of the cost report to identify those areas of the report that are most likely to be reviewed and questioned when audited. Determine if controls exist to assure unallowable costs such as advertising is eliminated from the cost report. Also, past audits have shown that the
areas below are risk areas and determine what controls are in place to assure accurate reporting:

a. Graduate Medical Education and Indirect Medical Education Costs – calculated based on the number of FTE residents and by proportion of Medicare days of care.
b. Bad Debt Write-offs – write-offs for not being able to collect the Medicare co-payments are allowed if adequate records exist to show sufficient effort in attempting to collect the co-pay amounts.
c. Disproportional Funds – As part of Medicare reimbursement, there is a disproportional share augmentation that is a percentage increase over the base DRG reimbursement. The percentage increase is determined based on Medicaid eligible days and thus the external audit reviews the accuracy of the Medicaid eligible days.

Business Processes

9. Identify all key hospital activities that impact the preparation of the cost report. Document positions with responsibility for coordinating and controlling the cost report processes. Document processes via flowcharts or narratives, identifying process strengths, weaknesses, and mitigating controls.

10. If processes do not appear adequate, develop detailed test objectives and procedures, and conduct detailed transaction testing with specific test criteria.

Information Systems

10. Interview hospital financial services management and staff and information systems personnel to identify all manual or electronic information systems used to accumulate data that is used to prepare the cost report. Obtain and review systems documentation to the extent available. Otherwise, document information flow via flowcharts or narratives, including all interfaces with other systems, noting the following:
   a. Are the systems manual or electronic?
   b. Does the system interface with other administrative information systems? If yes, is that interface manual or electronic?
   c. What type(s) of source documents are used to input the data?
   d. What types of access controls are in place within the automated system?
   e. What types of edit controls are in place within the automated system?
   f. For what purposes is the system used?
   g. Who performs review of the system’s output to ensure correct information?
   h. Is a disaster/back-up recovery system in place for this system?
   i. What is the retention period for source documents and system data?

11. Evaluate the adequacy of the information systems to provide for availability, integrity, and confidentiality of University information resources.
12. If system controls do not appear adequate, develop detailed test objectives and procedures, and conduct detailed testing with specific test criteria.

C. Following completion of the general overview steps outlined above, a high-level risk assessment should be performed and documented. To the extent necessary, as determined by the auditor, this risk assessment may address aspects of other areas outlined below (financial, compliance, operational efficiency and effectiveness, and information systems). In addition to the evaluations conducted in the general objectives section, the risk assessment should consider the following: time since last review, recent audit findings, organizational changes, regulatory requirements, etc.

III. Financial Reporting (Estimated time to complete – 150 hours)

A. The following table summarizes audit objectives and corresponding high-level risks regarding financial reporting processes.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Areas of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluate the accuracy and integrity of the cost report and supporting financial data.</td>
<td>- Data errors or omissions result in inaccurate reporting and lead to financial ramifications to the hospital.</td>
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<tr>
<td></td>
<td>- Inaccurate or insufficient accounting for revenue and expenditures results in poor estimates of reserves.</td>
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</tbody>
</table>

B. The following procedures should be considered whenever the audit is conducted.

1. Identify key reporting systems that provide data used in the cost report and obtain an understanding of the control measures in place to assure accurate and complete financial reporting.

2. Document the financial processes through spreadsheets, narratives, or flowcharts.

3. Obtain copies of the prior fiscal year Provider Statistical and Reimbursement Reports (PS&R) for the hospital and sub-provider Inpatient Patient Part A and B, outpatient (including All Other, Renal, Orthotic/Prosthetic, Part B Vaccine, ASC, O/P Radiology, and O/P Other Diag.) and Home Health Agency Part A and B.
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4. Obtain copies of the PIP (provider interim payment) schedule and accompanying Fiscal Intermediary correspondence related to any lump sum payments provided in the prior fiscal year. Verify that all scheduled PIP payments per the remittance advices have been received and recorded accurately.

5. Determine if last audited cost report can be used to substantiate (i.e., determine reasonableness) some of the cost report data.

6. Obtain copies of the audited financial statements and audited general ledger.

7. Verify that allocations used for reporting are reasonable. Specifically confirm that square footage used to allocate costs has been confirmed as being accurate.

8. Perform the following audit procedures on the prior year’s cost report.

   a. Worksheet S – this worksheet is the result of the cost report calculation and reports the total due/to/from the Medicare program. Verify that reported amounts can be traced and agreed to other applicable worksheets.

   b. Worksheet S-3 Part I – Medicare/Medi-Cal Days and Discharges, Interns and Residents FTE count. Verify that:

      - Total days agrees to census reports.
      - Medicare/Medi-Cal patient days and discharges agrees to census reports and the PS&R. Allocation of days to cost report lines should agree to hospital financial reports that summarize paid and unpaid days. Determine appropriateness of allocation.
      - Statistics flow through to Worksheet D-1, and all other parts of the cost report.
      - Interns and Residents FTE count traces and agrees to supporting documentation. Inquire of staff the process to calculate FTE’s and determine reasonableness of process.

   c. Worksheet S-4 – this worksheet is the input for the Home Health visits, both total and Medicare. Verify that these visits agree to the Home Health PS&R or internal detail reports. If PS&R statistics are not used, determine reasonableness of internal statistics.

      These statistics automatically flow through Worksheet H-6 and all other parts of the cost report.

   d. Worksheet A – Salaries and Other costs are direct input in columns 1 & 2. The software totals these costs in column 3.
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- The Total cost should be reconciled to the Total Cost on the audited General Ledger (GL).
- Trace a sample of high dollar cost centers to GL and other supporting documentation (e.g., Trial Balance of Expenses report)
- Columns 4 and 6 are direct feeds from the A-6 and A-8 Schedules.

**e. Worksheet A-6** – This worksheet is used to reclassify costs between cost centers on the cost report.

- Compare costs to prior year for reasonableness.
- Trace a sample of high dollar reclasses to supporting documentation.

**f. Worksheet A-8** – This worksheet is used to eliminate costs in the GL, which are not cost reimbursed, as well as to reduce costs for non-patient revenue, which is generated in the departments. It is also used to add back costs from a prior year, which had been disallowed previously.

- Adjustments should be compared to prior year for reasonableness.
- Trace a sample of high dollar adjustments to supporting documentation.

**g. Worksheet A-8-1** – This worksheet is used to disclose the related party costs that are allowable. Determine if an amount is shown and trace back to supporting documentation.

**h. Worksheet B Parts I, II & III** – This is the allocation of overhead costs to the patient care cost centers and is calculated by the computer system. Test certain amounts for accuracy:

- Trace net expenses for cost allocation from Worksheet A.
- Test a small sample of allocations to verify software generated correctly (no override).

**i. Worksheet B-1** – These are the statistics that are used to allocate the overhead cost to the patient care cost centers.

- Inquire whether there have been any changes to the statistics used.
- Compare statistics to prior year for completeness and reasonableness.
- Select a sample of statistical bases and agree to supporting documentation.

**j. Worksheet C Part I** – This worksheet is used to calculate the cost to charge ratio for each ancillary department. Total Patient Revenue is the only input here in column 6.
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- Reconcile Total Patient Revenue to the financial statements. Trace a sample of high dollar amounts to supporting documentation.
- Compare the Cost to Charge ratios to prior year for reasonableness and explain significant variances. Recalculate a sample to ensure accuracy.

k. Worksheet D Part V Title XVIII Part B – This worksheet is used to calculate the cost of services rendered to Medicare Outpatients.

- Verify revenue amounts by tracing to the PS&R and revenue crosswalk.
- Recalculate the program costs for a small sample to ensure accuracy (no override).
- Compare cost to charge ratios to last audited cost report. Determine reasonableness.

l. Worksheet D-1 Title XVIII Sub Providers (Part 1 & 2) – this schedule is used to calculate the total cost of services provided to the cost based patients, as well as to compare this cost to either the TEFRA or MIRL Caps. Confirm the target amount per discharge, line 55, to the latest information from the intermediary adjusted for inflation for the current year.

m. Worksheet D-4 – This worksheet is used to calculate the ancillary cost for Title XVIII SNF’s and Sub Providers, as well as the title XIX cost for those hospitals with cost based Medi-Cal. Confirm ancillary charges to the PS&R and revenue crosswalk and take into consideration estimated A/R after the PS&R date.

n. Worksheet D-6 Parts I and II – This worksheet is used to calculate the organ acquisition costs and report the number of organ acquisition days. Trace revenue and days to supporting documentation.

o. Worksheet D-6 Parts III and IV – This worksheet is used to compare organ acquisition costs and charges and calculate the ratio of Medicare usable kidneys.

- Trace costs and charges to other worksheets.
- Trace number of reported usable kidneys to supporting documentation.

p. Worksheet E Part A – This worksheet is the settlement page for Medicare PPS patients.

- Trace payments to PS&R including unpaid Medicare claims.
- Verify IME percentage and adjustment.
- Trace SSI and Medicaid percentages to fiscal intermediary correspondence.
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- Verify DSH percentage and adjustment.
- Verify I/P program capital by tracing to PS&R.
- Verify Organ Acquisition costs.
- Trace primary payer payments, deductibles, and coinsurance to PS&R.
- Trace Interim Payments to PIP schedule and fiscal intermediary correspondence.

q. Worksheet E Part B – This worksheet is the settlement page for Medicare Outpatients.
   - Trace primary payments, deductibles, and coinsurance to PS&R.
   - Trace protested amounts to source documents.

r. Worksheet E Parts C, D, E – These worksheets are for the Ambulatory Surgical Center, Outpatient Radiology, and Other Outpatient Diagnostic Procedures.
   - Trace overhead and prevailing charge amounts and deductibles to PS&R.
   - Verify blend percentages for hospital and costs are correct per the Provider Reimbursement Manual (can be viewed on-line via Internet).

s. Worksheet E-1 - This worksheet is used to list all the payments paid to the provider during the year.
   - All payments should be tied out to fiscal intermediary documentation (e.g., PIP payments and lump sum distributions).
   - Confirm in-transit payments were handled correctly.

t. Worksheet E-3 Part 1 – This worksheet is used to calculate the net Due Program/provider. Negative is due the program; positive is due the provider. Trace deductibles and coinsurance to PS&R.

u. Worksheet E-3 Part IV – This schedule is used to calculate the Direct Graduate Medical Education reimbursement for Medicare Part A and Part B.
   - Total FTEs should agree with supporting documentation and Worksheet S-3 Part I.
   - Trace updated per resident amount to fiscal intermediary correspondence.
   - Trace primary payer payments to the PS&R.

v. Worksheet H – The H worksheets are used to calculate the cost of services for the home health patients.
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- H-6 – the program cost limits should be verified with the PS&R.
- H-7 - trace interim payments to the PS&R and lump sum adjustments should be traced to fiscal intermediary correspondence.

w. Worksheet L – This worksheet reports the amounts for capital payments. Confirm payments to supporting documentation.

IV. Compliance (Estimated time to complete – 20 hours)

A. The following table summarizes audit objectives and corresponding high-level risks regarding compliance with policies, procedures, and regulatory requirements.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Areas of Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluate compliance with CMS regulations on completion and filing of cost report.</td>
<td>Non-compliance with CMS regulations may result in financial loss to the hospital.</td>
</tr>
</tbody>
</table>

B. The following procedures should be considered whenever the audit is conducted.

1. Determine if the cost report has been completed and filed within timeframes specified by CMS.

2. Determine if the hospital has an external consultant review the cost report for accuracy prior to submitting the report to the intermediary.

3. Determine what processes are in place in the hospital’s financial services department to ensure compliance with CMS regulations and applicable University policy.

4. If it does not appear that processes provide reasonable assurance of compliance, develop detailed test procedures and criteria to evaluate **
V. Operational Effectiveness and Efficiency (Estimated time to complete – 20 hours)

A. The following table summarizes audit objectives and corresponding high-level risks regarding operational effectiveness and efficiency.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Areas of Risk</th>
</tr>
</thead>
</table>
| Evaluate effectiveness and efficiency of the procedures and systems used in getting the cost report completed and filed. | • Poor business practices and oversight could result in an inaccurate cost report submitted to the fiscal intermediary.  
• Documentation is not organized or does not exist to support amounts reported in the cost report  
• Staff are not trained or given continuing education to assure cost report is accurately completed. |

B. Based on the information obtained during the general overview, financial reporting, and compliance sections, determine whether any operations should be evaluated further. For example, the following procedures should be considered:

1. Identify different sources of data for completing the cost report and assess whether information needed is readily available to expedite cost report completion.

2. Review record keeping practices to assure supporting records are organized, and retained in a location that is only accessible to authorized hospital management and staff.

3. Verify that effective reporting exists to bring significant cost report issues identified during the preparation of the cost report or when it is being audited to the attention of the hospital Chief Financial Officer and/or the Chief Executive Officer.

VI. Information Systems (Estimated time to complete – 10 hours)

A. The following table summarizes audit objectives and corresponding high-level risks regarding information systems.
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<table>
<thead>
<tr>
<th>Audit Objective</th>
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</tr>
</thead>
</table>
| Evaluate systems, applications, and databases to assure reasonable internal controls exist to maintain the integrity and availability of data needed to complete the cost report. | - Security management practices may not adequately address information assets, data security policy, or risk assessment.  
- Application and systems development processes may result in poor design or implementation.  
- The confidentiality, integrity, and availability of data may be compromised by ineffective controls (physical, logical, operational).  
- Disaster recovery and business continuity planning may be inadequate to ensure prompt and appropriate crisis response. |

B. The following should be completed:

1. Identify any significant changes to information systems or corresponding business processes.
2. Evaluate the impact of any significant changes to the overall system of internal controls.

C. In addition, consider two-way tests of data through systems from source document to final reports, and from reports to original source documents.

D. Based on the information obtained during the information systems overview, evaluate whether any information resources should be evaluated further.

REFERENCES