Department OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date JUL 18 1996

From June Gibbs Brown
Inspector General

Subject Audit of Administrative Costs Claimed Under Parts A & B of the Health Insurance for the Aged and Disabled Program - Associated Insurance Companies, Inc., Indianapolis, Indiana (A-05-94-OO080)

To Bruce C. Vladeck
Administrator
Health Care Financing Administration

This memorandum is to alert you to the issuance on July 19, 1996 of our final report. A copy is attached.

The audit covered the costs claimed by Associated Insurance Companies (Associated) on final administrative cost proposals for Fiscal Years 1990 through 1993. Costs audited totaled $31,115,926 for Part A and $73,582,826 for Part B.

Of the total $104,698,752 claimed, we are recommending a financial adjustment of $3,954,632 ($1 ,245,146 for Part A and $2,709,486 for Part B). Adjustments are necessary because Associated:

- understated complementary insurance credits by $2,401,204. Charges to complementary insurers did not include cost allocations from all cost centers that supported claims processing activity.

- claimed executive salary increases of $479,479 which exceeded the average increases for comparable positions, as measured by the Federal Bureau of Labor Statistics.

- claimed pension costs of $313,179 based on accrual accounting entries instead of actual cash contributions. An additional $1,198 of pension costs claimed was . unrelated to Medicare.

- claimed $88,377 of deferred compensation costs based on accrual accounting entries instead of actual cash contributions. An additional $82,858 was for premiums on employee insurance policies which listed the company as beneficiary.

- claimed $169,277 of professional consultant costs for services unrelated to Medicare.

- claimed $162,151 of indirect cost allocations that were for non-Medicare related costs .

- overstated return of investment by $67,230 because amounts were inconsistently calculated between fiscal years.

- claimed $56,958 of post-retirement benefit costs based on accrual accounting entries instead of actual cash contributions.

- claimed $45,070 of executive car allowances that were unsupported and $10,885 for other employees' mileage reimbursements that exceeded amounts permitted under Federal Travel Regulations.

- claimed $49,480 of interest costs that are not allowable under Federal regulations.

- claimed $26,240 for advertising, entertainment, dues, and contributions that were for non-Medicare related activities.

- claimed $1,046 for a late payment of property tax penalty that is not allowable under Federal regulations.

In response to our draft report, Associated agreed to $516,314 of our recommended financial adjustments (pension costs - $288,388; indirect cost allocation - $562; automobile costs - $10,236; interest costs - $49,480; professional consultants - $166,602; and property taxes - $1,046) and disagreed with the remaining amounts questioned.

For further information, contact:

Paul P. Swanson
Regional Inspector General
for Audit Services
Region V
(312) 353-2618

Attachments

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

AUDIT OF ADMINISTRATIVE COSTS CLAIMED UNDER PARTS A & B OF THE HEALTH INSURANCE FOR THE AGED AND DISABLED PROGRAM

ASSOCIATED INSURANCE COMPANIES, INC., INDIANAPOLIS, INDIANA

JUNE GIBBS BROWN
Inspector General

JULY 1996
A-05-94-00080

DEPARTMENT OF HEALTH AND HUMAN SERVICES

REGION V
105 W ADAMS ST
CHICAGO. ILLINOIS 60603.620 I

OFFICE OF
INSPECTOR GENERAL

Common Identification No. A-05-94-00080

Mr. Dennis Brinker, CPA
Chief Financial Officer and Vice President
AdminaStar Federal, Inc.
P.O. Box 50454
Indianapolis, Indiana 46250-0454

Dear Mr. Brinker:

Enclosed for your information and use are two copies of an Office of Inspector General (OIG) audit report entitled, "Audit of Administrative Costs Claimed Under Parts A & B of the Health Insurance for the Aged and Disabled Program." The audit covered the period October 1, 1989 through September 30, 1993. A copy of this report will be forwarded to the HHS action official named below, for her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the action official. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), Office of Inspector General audit reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR Part 5).

To facilitate identification, please refer to the above Common Identification Number in all correspondence relating to this report.

Sincerely,

for
Paul Swanson
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to:
Ms. Daly Vargas
Associate Regional Administrator

I

SUMMARY

Associated Insurance Companies, Inc. (AIC) receives, reviews, audits, and pays both Medicare Part A and Part B claims under agreements with Blue Cross and Blue Shield Association and the Health Care Financing Administration. The AIC is entitled to reimbursement for its allowable administrative costs incurred. For the period October 1, 1989 through September 30, 1993, AIC claimed administrative costs, for Medicare Parts A and B, as follows:

Fiscal Year	Part A	Part B	Total
1990	$ 7,155,041	$15,181,118	$ 22,336,159
1991	7,349,105	17,116,974	24,466,079
1992	7,972,077	18,504,800	26,476,877
1993	8,639,703	22,779,934	31,419,637
Total	$31,115,926	$73,582,826	$104,698,752

Of the $104,698,752 in administrative costs claimed, we are recommending financial adjustments of $1,245,146 (Part A) and $2,709,486 (Part B). These amounts are detailed in the Exhibits and the Findings and Recommendations section of the report.

We found that Medicare costs were overstated because:

- Complementary insurance credits were understated by $2,401,204 because AIC's charges to complementary insurers did not include cost allocations from all cost centers that support claims processing activity.

- Salary increases for some of AIC's executives exceeded average increases for comparable positions, as measured by the Federal Bureau of Labor Statistics, by $479,479.

- Pension costs of $313,179 were charged to Medicare based solely on accrual accounting entries instead of actual cash contributions. Additional pension costs claimed of $1,198 were unrelated to Medicare.

- Deferred compensation costs of $88,377 were based on accrual accounting entries instead of actual cash contributions. Additional deferred compensation costs claimed of $82,858 were for premiums on employee life insurance policies. AIC is the beneficiary on the policies and insurance proceeds are not restricted for use as deferred compensation.

- Professional consultant costs claimed of $169,277 were for services unrelated to Medicare.

- Indirect cost allocations to Medicare of $162,151 were for non-Medicare related costs.

- Return on investment costs were inconsistently calculated from one fiscal year to the next, causing both overstatements and understatements in charges to Medicare. The net result was a cumulative overstatement of $67,230.

- Post-retirement health benefits costs of $56,958 were based solely on accrual accounting entries instead of actual cash contributions.

- Executive car allowances of $45,070 were unsupported, and other employees' mileage reimbursement costs exceeded amounts permitted under Federal Travel Regulations by $10,885.

- Interest costs of $49,480 were charged to Medicare. Federal regulations do not allow interest costs on borrowing.

- Advertising, entertainment, dues, and contributions totaling $26,240 were charged to Medicare although the costs were applicable to non-Medicare activities.

- Costs of a penalty of $1,046 for late payment of property taxes are unallowable.?

AUDITEE COMMENTS

AIC concurred in $516,314 of our recommended financial adjustments (pension costs - $288,388; professional consultants - $166,602; indirect cost allocations - $562; automobile costs - $10,236; interest costs - $49,480; property taxes - $1,046) and disagreed or did not respond to the remaining amounts questioned. In some instances, AIC provided additional information, regarding items questioned in our draft report, not available to us during our field work, This final report has been adjusted to reflect this additional information. AIC's written comments are summarized at the end of each finding and are attached as an Appendix to this report.

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INTRODUCTION

BACKGROUND

Health Insurance for the Aged and Disabled (Medicare) was established by Title XVIII of the Social Security Act. Hospital Insurance (Part A) provides protection against the cost of hospital and related care. Supplemental Medical Insurance (Part B) is a voluntary program that covers physician services, hospital outpatient services and certain other health services.

The Health Care Financing Administration (HCFA) administers the Medicare program. Under an agreement with HCFA, the Blue Cross and Blue Shield Association (BCBSA) participates as a Medicare intermediary to assist in program administration. Under a subcontract with BCBSA, Associated Insurance Companies, Inc. (AIC) receives, reviews, audits, and pays Medicare Part A claims. Under a separate agreement with HCFA, AIC participates as a Medicare carrier and performs the same functions for Medicare Part B claims. Subject to limitations specified in the agreements, AIC is entitled to reimbursement for reasonable administrative costs incurred.

From October 1, 1989, through September 30, 1993, AIC claimed $104,698,752 in administrative costs.

SCOPE OF AUDIT

Our audit was conducted in accordance with generally accepted government auditing standards. The audit objective was to determine whether Medicare Part A and B administrative costs claimed by AIC on its "Final Administrative Cost Proposals" (FACP) were reasonable, allocable and allowable. We examined the administrative costs claimed by AIC to determine whether the amounts were in accordance with (i) Federal Acquisition Regulation (FAR) Part 31, (ii) the Carrier/Intermediary Manual, and (iii) the Medicare Agreements. We also reviewed salary increases given to AIC's executives and the reasonableness of resultant cost allocations to Medicare.

Our examination included audit procedures designed to achieve our objective and a review of accounting records and supporting documentation. The audit covered the period October 1, 1989 through September 30, 1993. Audit fieldwork was performed at AIC's offices in Indianapolis, Indiana from August 1994 through March 1995.

Our audit did not cover pension segmentation. A separate audit of the AIC pension plan for compliance with segmentation requirements will be performed at a later date.

FINDINGS AND RECOMMENDATIONS

COMPLEMENTARY **INSURANCE** CREDITS

The AIC understated complementary insurance credits, which are a required offset to amounts claimed as Medicare administrative costs, causing the FACPs to be overstated by $2,401,204. The AIC's cost allocations to complementary insurers included only cost centers directly involved in complementary insurance activity. Other cost centers which benefitted claims processing activity, such as Medicare secondary payer and hearings and inquiries, were excluded from the cost allocations.

The Medicare Intermediary Manual (section 1601.c) states that charges to complementary insurers should include cost allocations from all cost centers that support the intermediary's claims processing activity. HCFA Program Memorandum, AB-95-1, illustrates the application of section 1601 by stating that the cost allocations should include costs from areas such as Medicare secondary payer and hearings and inquiries.

Because AIC did not adhere to provisions of the Manual section and supplemental memorandum cited above, Medicare was overcharged by $2,401,204.

RECOMMENDAT ION

We recommend that AIC make a financial adjustment of $2,401,204, as follows:

	Part A	Part B	Total
FY 1990:	$149,341	$ 537,975	$ 687,316
FY 1991:	125,604	437,898	563,502
FY 1992:	111,440	457,608	569,048
FY 1993:	104,878	476,460	581,338
	$491,263	$1,909,941	$2,401,204

Auditee Response

AIC disagreed with our financial adjustment recommendation. AIC believes that the HCFA program memorandum AB-95-1 was used only as a guide to determine the fixed rates that were implemented in January, 1995 and that this guide was not intended to be applied retroactively. AIC believes that allocations from cost centers such as Medicare secondary payor, recons and hearings, inquiries, and medical review should not be included in the complementary insurance rate.

Auditors Response

The HCFA program memorandum AB-95-1 was based on criteria contained in the Medicare Intermediary Manual throughout the audit period. The memorandum only illustrated, with examples, the existing provisions of the Manual. Our finding merely reiterates the long standing principle that all costs which benefit an activity should be allocated to that activity.

EXECUTIVE SALARY INCREASES

Salary increases for AIC executives significantly exceeded average increases for comparable positions as measured by the Employment Cost Index established by the Bureau of Labor Statistics (BLS). The resulting charges to Medicare were $479,479 higher than if ECI statistics had been used as a guide for executive salary increases.

The ECI represents dozens of indices that are calculated for various occupational and industry groups to measure the rate of change in employee compensation. It is a fixed weight index at the occupational level and eliminates the effects of employment shifts among occupations. The ECI is distinguished from other surveys in that it covers all establishments and occupations in both the private nonfarm and public sectors. We used the index for executive compensation because we considered it to be the most equitable and relevant.

Regulations contained at 48 CFR 31.201-3(a) state that a cost is reasonable if it does not exceed what a prudent person would incur in the conduct of competitive business. In addition, 48 CFR 21.205-6(b) states "...Compensation is reasonable if each of the allowable elements making up the employee's compensation package is reasonable. ..Relevant factors include general conformity with compensation practices of other firms of the same size, industry and the geographical location. . . ." Salary increases received by AIC executives did not meet this standard for reasonableness.

The ECI for executives in managerial/administrative areas disclosed that average salary increases during the period covered by our audit were, as follows:

FY 1990	5.4%	FY 1992	1.7%
FY 1991	4.1%	FY 1993	3.3%

Salary increases exceeding the above rates resulted in $479,479 of unreasonable charges to the Medicare program.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $479,479, as follows:

	Part A	Part B	Total
FY 1990:	$ 21,766	$ 27,612	$ 49,378
FY 1991:	38,272	51,382	89,654
FY 1992:	85,972	110,132	196,104
FY 1993	61,228	83,115	144,343
	$207,238	$272,241	$479,479

Auditee Response

AIC disagreed with our financial adjustment recommendation. AIC believes that the regulations cited in the report do not require conformance to prescribed percentages for salary increases. In addition, AIC states that there were many changes in its organization during the audit period which affected compensation levels and that many of the executives included in our analysis had changes in levels of responsibility that affected compensation. AIC further stated that our analysis included incentive payments, and they doubted that the BLS information included incentive payments.

Auditor Response

Our analysis did consider changes within AIC's organization such as retirements, new-hires, and management incentive payments. Regarding changes in job responsibilities, our review included the six executives that AIC'S response maintained had significant increases in responsibility. We found that these six executives had cumulative increases in their compensation package over the audit period ranging from 87 to 116 per cent. The related Bureau of Labor Statistic's cumulative increase was only 14.5 per cent. These executives did have changes in job titles during the audit period, but, while titles changed, the level of responsibility did not. These individuals were always essentially the CEOs/VPs within their respective division and subsidiary company. Therefore, we do not believe charging Medicare for compensation increases exceeding the BLS averages was justified.

The statistics from the BLS "Employment Cost Index" included salaries, bonuses, incentive payments, commissions, retirement, and cost-of-living adjustments.

PENSION COSTS

The AIC overstated pension costs on the FACPS by $314,377 because pension costs were not funded by cash contributions ($313,179) and non-Medicare costs were included in amounts claimed ($1,198) .

Regulations at 48 CFR 31.205-6(j) (2) (i) state that pension costs must be funded before an organization's Federal income tax return is due. Pension costs assigned to the current year, but not funded by the due date, are not allowable in a subsequent year.

The AIC did not fund its pension plan with cash contributions. Charges to the FACPS totaling $313,179 were based on accrual entries only. The AIC did not make required contributions because its actuary determined that cash contributions were not necessary to cover the fund's current liabilities. In addition, AIC claimed $1,198 for pension costs that were not related to Medicare.

RECOMMENDAT IONS

We recommend that AIC:

1. Make a financial adjustment of $314,377, as follows:

	Part A	Part B	Total
FY 1990:	$ 5,142	$ 5,574	$ 10,716
FY 1991:	37,679	40,904	78,583
FY 1992:	38,171	41,678	79,849
FY 1993:	68,974	76,255	145,229
	$149,966	$164,411	$314,377

2. Establish procedures to ensure that unfunded and non-Medicare pension costs are not charged to Medicare.

Auditee Response

AIC concurred with $287,190 of our recommended financial adjustment on pension costs not funded by cash contributions and the $1,198 which was unrelated to Medicare. Part of AIC's response concerned $1,136 relating to duplicate accruals that we had questioned in our draft report. After examining AIC's additional supporting documentation for the $1,136, we removed the questioned amount from this final report.

AIC disagrees with the remaining $25,989 questioned. This amount represents the cost of AIC's Supplemental Executive Retirement Plan (SERP) for highly compensated executives. AIC states that SERP is a deferred compensation plan which is not subject to the cited pension plan regulations and that AIC is not required to fund the SERP plan for the costs to be allowable.

AIC also states that in previous OIG audits only part of the SERP costs were disallowed based on a present value calculation of the accrual entries as covered in section 30.415.40(b) of the FAR.

Auditor Response

Since employees or their survivors can access SERP funds only after an employee's retirement, disability, termination of employment, or death, we consider the SERP to be covered under the pension plan regulations.

We departed from the position taken in prior audits after making a more comprehensive review of this issue. The prior audits were performed by an independent auditor under a contract with us.

DEFERRED COMPENSATION

The AIC overstated the FACPS by $171,235 for deferred compensation costs. Costs of $88,377 were charged to Medicare based solely on accrual accounting entries, rather than actual cash contributions. In addition, AIC charged Medicare $82,858 for premiums on employee life insurance. The amount of life insurance proceeds, payable to AIC, is not available until an employee dies, and the proceeds are not restricted for use as deferred compensation.

Essentially, AIC's deferred compensation plan represents a supplemental pension plan that AIC offers to its "highly compensated" employees. The plan supplements AIC's regular 401(k) plan. The AIC accrued deferred compensation costs of $88,377 based on estimates, without a corresponding cash set aside, and charged the costs to Medicare.

Regulations contained at 48 CFR 31.205-6(j) (i) state that pension costs must be funded before a Federal income tax return is due. Pension costs assigned to the current year, but not funded bythe due date, are not allowable in a subsequent year. The AIC did not make required contributions to fund its deferred compensation plan.

We also found that AIC purchased life insurance policies on participants in the deferred compensation plan, ostensibly to provide a source of funds for future payouts. However, AIC is the beneficiary under these policies, and the insurance proceeds are not restricted for use as deferred compensation.

The AIC charged Medicare for both the life insurance premiums ($82,858) and the accrual accounting entries ($88,377). Both charges are unallowable since neither charge is for a cash contribution to a set aside fund.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $171,235, as follows:

	Part A	Part B	Total
FY 1990:	$11,495	$12,461	$ 23,956
FY 1991:	22,455	24,378	46,833
FY 1992:	25,860	28,235	54,095
FY 1993:	22,014	24,337	46,351
	$81,824	$89,411	$171,235

Auditee Response

AIC disagrees with our financial adjustment recommendation. In general, AIC states that the deferred compensation expenses consist of (i) the company match on amounts deferred by plan participants, (ii) the interest accruals on total company liabilities to the plan participants, and (iii) a portion of the premium payments for life insurance policies that exceeds the increase in cash surrender value of those policies.

AIC states that their plan is a "non-qualified" deferred compensation plan that should be subject to deferred compensation regulations instead of pension regulations. AIC states that deferred compensation regulations at Sections 30.415 and 31-205-6(k) of the Federal Acquisition Regulations (FAR) do not contain the same funding requirements that are applicable to pension plans.

AIC states that one of the requirements for an unqualified deferred compensation plan is that it not be funded by cash contributions . AIC states that Section 30.415-40(b) of the FAR indicates that the amount of deferred compensation claimed shall be the present value of the future benefits to be paid and that Section 30.415-50(d) indicates that interest expense is an allowable component of deferred compensation costs.

AIC also states that our recommended financial adjustment for the employee life insurance premiums should be reduced by $19,817 to $5,181 because we did not consider credit entries to Cash Surrender Value in FY 1993.

Auditor Response

AIC's deferred compensation plan is a supplemental pension plan that allows the "highly compensated" executives to increase their retirement compensation. As such, AIC's plan meets the definition of a "non-qualified" defined benefit pension plan as described in 48 CFR 31.205-6(j)(3).

We did incorporate the credit entries to Cash Surrender Value mentioned by AIC in its response.

PROFESSIONAL CONSULTANTS

The AIC overstated the FACPS by $169,277 for professional consultant services not related to Medicare. Amounts claimed included affiliate and private business costs.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $169,277, as follows:

	Part A	Part B	Total
FY 1990:	$15,771	$ 17,305	$ 33,076
FY 1991:	31,469	34,163	65,632
FY 1992:	8,977	9,952	18,929
FY 1993:	24,520	27,120	51,640
	$80,737	$ 88,540	$169,277

2. Establish procedures to ensure non-Medicare professional consultant costs are not charged to Medicare.

Auditee Response

AIC concurred in $166,602 of amounts recommended for adjustment. AIC disagreed with $2,059 of our financial adjustment recommendation stating that although the original documentation for this unsupported cost could not be located, AIC assumes that the cost was for the design and implementation of a corporate budget system.

AIC also disagreed with an amount of $616 because they were unable to identify the item to the account, Legal Services Non-Government.

Part of AIC's response included explanations for draft report adjustments of $22,629 in Personal Services, $889 in unsupported costs, and journal voucher adjustments noted on our workpapers ($16,495, $2,414, and $425). After examining AIC's supporting documentation, we removed the items from our recommendation in this final report.

Auditor Response

Without documentation", we cannot determine if the $2,059 was allocable to the Medicare program.

We provided AIC with information on where the $616 cost was located. AIC made no further response.

INDIRECT COST ALLOCATIONS

The AIC overstated the FACPS by $162,151 because indirect costs unrelated to Medicare were allocated to the program. costs unrelated to Medicare included amounts applicable to the corporate medical director, the chief investment officer, and sales commissions and promotions.

The Medicare contracts state that all costs that relate to AIC's non-Medicare business are unallowable. Further, regulations contained at 48 CFR 31.201-4 state that a cost is allocable or chargeable to one or more cost objectives only on the basis of relative benefits received or other equitable relationship.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $162,151, as follows:

	Part A	Part B	Total
FY 1990:	$ 6,445	$ 6,986	$ 13,431
FY 1991:	12,323	13,375	25,698
FY 1992:	50,956	56,190	107,146
FY 1993:	7,511	8,365	15,876
	$ 77,235	$ 84,916	$162,151

2. Establish controls to ensure that non-Medicare related costs are not charged to Medicare.

Auditee Response

AIC'S response covered cost items totaling $169,825 of the $198,321 questioned in our draft report. After reviewing additional supporting documentation submitted with the AIC response, we deleted or transferred $42,735 of the costs questioned in our draft report from our recommended financial adjustment in this final report. A summary of the total of items not addressed in AIC's response together with areas covered by the response and our determinations is shown below:

	Questioned in Draft	Resolved	Remains Questioned
No response items	$28,496	$ 0	$ 28,496
Transfer from Advertising	0	0	6,565
Transfer to Def. Comp.	0	10,268	(10,268)
Non-Deferred Comp. Costs	57, 854	15,909	41,945
Excluded Acct. Allocation'	23,260	15,265	7,995
Corporate Oft. Allocations	88,711	1,293	87,418
Totals	$198,321	$42,735	$162,151

Non-Deferred Comp Costs - With its response, AIC submitted additional support for questioned amounts totaling $15,909. As a result, we accepted this additional information and deleted questioned amounts pertaining to the errors and omissions insurance item in FY 1990 amounting to $74,867 ($8,298 Medicare share), a management fee charged in FY 1993 of $13,800 ($1,050 Medicare share) , and the FY 1993 employee benefit package of $88,454 ($6,561 Medicare share).

We also accepted AIC's cost classification rationale for a FY 1991 item of $82,925 ($10,268 Medicare share) and reclassified this questioned item into the Deferred Compensation section of this report.

Regarding response items that we did not agree with:

AIC stated that $27,428 represents a cost allocation to Medicare from the cost center, Human Resource Information System, which performed functions for the entire company and should be partially allocable to the Medicare program. The amount includes $16,385 recorded in FY 1992 and $11,043 recorded in FY 1993.

AIC stated that they have been unable to find supporting documentation for the FY 1993 Acordia credit entries made in December 1992 and January 1993 ($4,338 Medicare share) . However, AIC believes the entries related to the segregation of Acordia benefits that became necessary when Acordia became a public company.

Excluded Account Allocation - Based on additional explanations and support submitted by AIC, we deleted our recommended financial adjustments pertaining to: $2,497 (Medicare share) of the Salaries - Sales Commissions account plus the Medicare share of corporate expenses for FY 1990 ($11,470), FY 1991 ($365), and FY 1992 ($933).

AIC agreed with our adjustment of $562 in the FY 1993 Penalties account.

Corporate Office Allocations - AIC provided additional support for $1,293 in the Corporate Affairs cost center. We removed the amount from our recommended financial adjustment.

AIC states that the cost allocation for the Corporate Medical Director for FY 1992 ($54,354 Medicare share) was for various consulting and coordination activities that supported the Medicare program. However, AIC stated that "around the beginning of FY 1993", they began to question the allocability of the costs to the Medicare program and ended the allocations in FY 1993.

AIC also states that a cost allocation for the Corporate Affairs cost center from mid-1991 through December 1992 ($34,357 Medicare share) was stopped on January 1, 1993. Although AIC stated that the cost center manager provided AIC with information that supports the cost allocations, no details were provided in AIC's response.

Auditor Response

The supporting information AIC supplied for the $27,428 indicates the Human Resource Information System's primary function for the period in question was to convert the payroll systems of several AIC non-Medicare subsidiaries to the "DBS Payroll System". Therefore, we do not believe the amount is allocable to the Medicare program.

Without documentation, we cannot determine if the $4,338 for the Acordia credit entries is allocable to the Medicare program.

The job description and other information that AIC supplied concerning the Corporate Medical Director indicate that the Director's activities do not significantly complement, assist, or aid the activities of the Medicare Medical Director. Therefore, we do not believe the amount of $54,354 is allocable to the Medicare program.

Information AIC supplied concerning $34,357 for the Corporate Affairs cost center indicates that the costs were primarily for political information gathering, i.e., "re-evaluating the legislative districts regarding races for the Indiana General Assembly." Such costs are not allocable to the Medicare program.

RETURN ON INVESTMENT

The AIC's return on investment (ROI) computations were not in compliance with its Medicare contract, causing both overstatements and understatements in amounts claimed during FYs 1990 through 1993. The net effect was an overcharge to Medicare of $67,230.

The Medicare contracts state that the ROI will be determined by multiplying the average undepreciated balance of investment assets by the actual rate of return of the contractor's investment portfolio for the contract period.

The AIC did not consistently include all of its allowable investment assets in ROI calculations. The calculations were based on a annual beginning and ending net book value (NBV) figure for the investment cost centers allocated to Medicare. The AIC carried forward the total ending NBV figure each year to use as the beginning NBV figure for the following year. However, each year AIC allocated different investment cost centers to Medicare. As a result, the beginning NBV figure was applicable to a different number of cost centers than used for the ending NBV figure. This difference caused AIC to either overclaim or underclaim allowable ROI in the years covered by this audit.

RECOMMENDAT IONS

We recommend that AIC:

1. Make a financial adjustment of $67,230, as follows:

	Part A	Part B	Total
FY 1990:	$18,548	$11,720	$30,268
FY 1991:	23,187	27,611	50,798
FY 1992:	10,962	(26,293)	(15,331:)
FY 1993:	18,383	(16,888)	1,495
	$71,080	$(3,850)	$67,230

2. Establish procedures to ensure that consistent NBV figures are used in future ROI calculations.

Auditee Response

AIC agreed with our adjustments to asset valuations for the ROI computation but disagreed with the investment rates of return used in our calculation. AIC provided us with consolidated trial balances which were not available to us during our on-site review. AIC contended that the consolidated trial balances generally support the rates of return that they originally used in their ROI computations. They also contended that only a few immaterial variances exist. AIC would like the ROI computations to be based on the rates of return they originally used and the net book values of the cost centers recommended by OIG.

Auditor Response

We reviewed the consolidated trial balances provided by AIC and found them to contain too many variances and discrepancies to be useful in the ROI calculations.

POST-RETIREMENT HEALTH INSURANCE

The AIC overstated costs claimed on its 1993 FACP by $56,958 because it did not fund post-retirement health benefits in accordance with Statement of Financial Accounting Standards (SFAS) NO. 106 and applicable Federal regulations.

Starting in FY 1993, SFAS No. 106 requires that the expected costs of retiree health benefits be accrued during the employee's service years, rather than waiting for the costs to be incurred during retirement years. Also, assets must be segregated and restricted to provide for future benefits.

Regulations contained at 48 CFR 31.205-6(0) (2) state that retiree post-retirement health benefit costs must be paid either to (i) an insurer, provider, or other recipient as current year benefits or premiums or (ii) an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing health benefits to retirees. Retiree health benefit costs must be calculated in accordance with generally accepted actuarial principles and practices, and be funded by the time set for filing the Federal income tax return. Retiree health benefit costs assigned to the current year, but not funded or otherwise liquidated by the tax return due date, are not allowable in a subsequent year.

We found that post-retirement health benefit costs were not funded by AIC. The costs charged to Medicare were based on accrual accounting entries, not cash contributions to an insurer, provider, or trustee.

RECOMMENDAT IONS

We recommend that AIC:

1. Make a financial adjustment of $56,958 as follows:

	Part A	Part B	Total
FY 1993:	$27,051	$29,907	$56,958

2. Follow SFAS No.1O6 and the applicable Federal regulations to ensure that unallowable costs are not charged to Medicare in the future.

Auditee Response

AIC agreed that the post retirement health benefit costs were not funded in accordance with FASB 106. AIC disagreed with the cost allocation method that the OIG used to compute Medicare's share of the post retirement benefit costs paid in FY 1993. AIC believes that the cost allocation method should be based on active employee headcount.

Auditor Response

OIG's methodology was based on the methodology used by AIC's independent actuary. The actuary determined the retiree's location in AIC at the time of retirement. Active employee headcount should not be used as an allocation basis because the corporate structure has changed significantly since 1992.

AUTOMOBILE COSTS

AIC overstated the FACPS by $55,955, representing unallowable car allowances for executives and excessive mileage reimbursement for other employees. The Medicare contracts state that mileage costs charged to Medicare should not exceed the rate published in the Federal Travel Regulation (FTR), as issued by the General Services Administration (GSA) . In addition, the Medicare Intermediary Manual, appendix B, section 1156(G) (5) states that mileage should be business related and documented by the intermediary.

AIC paid selected executives a flat monthly fee ranging from $515 to $850 to reimburse the executives for the use of their personal automobiles in business travel. Total costs of $45,070 were unsupported because AIC did not require the executives to maintain mileage logs to document business miles traveled.

The AIC paid other employees for business related travel at the mileage rate specified by the Internal Revenue Service (IRS) for income tax purposes. Using the IRS mileage rate caused related claims to exceed the allowable amount (based on the FTR rate) by $10,885.

RECOMMENDATIONS

We recommend that AIC:

1. Make a financial adjustment of $55,955 as follows:

	Part A	Part B	Total
FY 1990:	$ 8,257	$ 9,952	$18,209
FY 1991:	5,239	6,887	12,126
FY 1992:	4,436	7,530	11,966
FY 1993:	4,584	9,070	13,654
	$22,516	$33,439	$55, 955

2. Follow the Medicare Intermediary Manual and Medicare contract terms when claiming costs for business travel.

Auditee Response

AIC accepted our recommended financial adjustment concerning mileage reimbursement ($10,885) , except for $649 which they contend represents an error in our workpapers.

AIC disagreed with the recommended financial adjustment of $45,070 concerning executive car allowances. AIC believes the car allowances are part of the executives' compensation packages and are not subject to business mileage record keeping requirements and travel rate limitations.

AIC also states that $1,293 of the questioned amount as automobile costs was also questioned in the Indirect Cost section of our draft report.

Auditor Response

Concerning the $649, the amount was accumulated from five separate accounts (Nos. 72103, 72201, 72209, 72303, 72306) and was not in error. We provided this information to AIC.

Regarding the $45,070, the Federal regulations cited in our finding provide for reimbursement of business mileage only.

We agree that $1,293 was inadvertently questioned twice in our draft report, and we have deleted the amount from indirect costs questioned in this final report.

INTEREST COSTS

The AIC claimed unallowable interest costs resulting in a net overstatement of $49,480 on the FACPS. Regulations contained at 48 CFR 31.205-20 state that interest costs on borrowing, however represented, are unallowable.

The AIC borrowed the money to pay the life insurance premiums on participants in the deferred compensation plan (see deferred compensation finding on page 5) . Interest costs applicable to the loans totaling $49,480 was charged to Medicare.

RECOMMENDATION

We recommend that AIC make a financial adjustment of $49,480 as follows:

	Part A	Part B	Total
FY 1990:	$ 6,095	$ 6,767	$12,862
FY 1991:	17,816	19,342	37,158
FY 1993:	(508)	(32)	(540)
	$23,403	$26,077	$49,480

Auditee Response

AIC concurred with the finding.

ADVERTISING, ENTERTAINMENT, DUES, & CONTRIBUTIONS

The AIC charged Medicare in error for advertising, entertainment, dues and contributions relating to its private line of business. Medicare was overcharged a total of $26,240 due to accounting errors.

Regulations at 48 CFR 31.205-14 state that costs of amusement, diversion, social activities, and any directly associated costs are unallowable.

The AIC recently began implementing controls to ensure that similar expenses are not charged to Medicare in the future.

RECOMMENDAT ION

We recommend that AIC make a financial adjustment of $26,240, as follows:

	Part A	Part B	Total
FY 1990:	$ 5,807	$ 6,293	$ 12,100
FY 1991:	3,157	3,064	6,221
FY 1992:	2,409	2,630	5,039
FY 1993:	1,186	1,694	2,880
	$12,559	$13,681	$ 26,240

Auditee Response

AIC submitted additional explanations and support for $64,477 questioned in our draft report. We have deleted this amount from our recommended financial adjustment.

The only other disputed item in the AIC response pertained to a FY 1993 charge in “Ads - Other” amounting to $6,585 ($6,565 Medicare share) . AIC contends that the amount represents a charge from the Human Resources department to the Corporate Offices for services performed.

Auditor Response

AIC could not substantiate the allocability of the $6,565 charge to the Medicare program. However, based on AIC’s response, we believe that this cost was miscoded into Advertising accounts, and we have transferred the amount into the Indirect Costs section of this report. AIC did not respond to the remaining items questioned.

PROPERTY TAXES

The AIC overstated the FY 1993 FACP by charging $1,046 to Medicare for a penalty applicable to late payment of property taxes. Regulations contained at 48 CFR 31.205-15 state that costs of fines and penalties resulting from violations of Federal, State, local, or foreign laws and regulations are unallowable.

RECOMMENDAT IONS

We recommend that AIC:

1. Make a financial adjustment of $1,046 as follows:

	Part A	Part B	Total
FY 1993:	$ 274	$ 772	$1,046

2. Establish procedures to ensure that late payment penalties are excluded from the costs charged to Medicare in the future.

Auditee Response

AIC concurred with the recommendations.

OTHER MATTERS

AIC claimed Indiana Gross Income Tax (IGIT) based on estimated gross receipts for each fiscal year. The findings in this report will likely reduce the amount of receipts when HCFA makes its final determinations. At that time, AIC should adjust downward a proportionate amount of the IGIT charged to Medicare during the period covered by this audit.

The HCFA requested that comments be included in this report concerning the accuracy of AIC's Interim Expenditure Reports (IERs). We reviewed the methodologies used to prepare the IERs, and our limited testing did not disclose any material inaccuracies or weaknesses other than those disclosed in the findings of this report.

EXHIBIT A

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
FOR THE FISCAL YEARS 1990 THROUGH 1993

Operation	Administrative costs
Bills Payment	$13,609,779
Reconsideration and Hearings	957,880
Medicare Secondary Payer	2,485,220
Medicare and Utilization Review	1,595,225
Provider Desk Reviews	4,151,202
Provider Field Audits	3,697,809
Provider Settlements	1,692,204
Provider Reimbursements	2,118,721
Productivity Investments	680,619
Fraud and Abuse	69,417
Other	57,850
Total Administrative Costs Claimed	$31,115,926
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 491,263
2. Executive Salary Increases	207,238
3. Pension	149,966
4. Deferred Compensation	81,824
5. Professional Consultants	80,737
6. Indirect Cost Allocation System	77,235
7. Return on Investments	71,080
8. Post-Retirement Health Insurance	27,051
9. Automobile	22,516
10. Interest	23,403
11. Advertising, Entertainment, etc.	12,559
12. Taxes	274
Total Adjustments	$ 1,245,146
Costs Recommended For Acceptance	$29,870,780

Note: Explanation of each adjustment is provided in the **"Findings and Recommendations"** section Of this report .

EXHIBIT B

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
FOR THE FISCAL YEARS 1990 THROUGH 1993

Operation	Administrative costs
Claims Payment	$40,548,826
Reviews and Hearings	5,155,430
Beneficiary/Physician Inquiry	8,035,141
Professional Relations	1,489,795
Medical and Utilization Review	8,714,845
Medicare Secondary Payer	1,824,896
Participating Physician	1,589,149
Productivity Investments	5,163,425
Fraud and Abuse	463,138
Other	598,181
Total Administrative Costs Claimed	$73,582,826
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 1,909,941
2. Executive Salary Increases	272,241
3. Pension	164,411
4. Deferred Compensation	89,411
5. Professional Consultants	88,540
6. Indirect Cost Allocation System	84, 916
7. Return on Investments	(3,850)
8. Post-Retirement Health Insurance	29,907
9. Automobile	33,439
10. Interest	26,077
11. Advertising, Entertainment, etc.	13,681
12. Taxes	772
Total Adjustments	$ 2,709,486
Costs Recommended For Acceptance	$70,873,340

Note: Explanation of each adjustment is provided in the "Findings and Recommendations" section Of this report .

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A) AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1990

Operation	Administrative costs
Bills Payment	$3,008,691
Reconsideration and Hearings	203,175
Medicare Secondary Payer	565,045
Medical and Utilization Review	406, 978
Provider Desk Review	1,007,856
Provider Field Audits	987,578
Provider Settlements	388,665
Provider Reimbursements	448,471
Productivity Investments	138,582
Total Administrative Costs Claimed	$7,155,041
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 149,341
2. Executive Salary Increases	21,766
3. Return on Investments	18,548
4. Professional Consultants	15,771
5. Deferred Compensation	11,495
6. Automobile	8,257
7. Indirect Cost Allocation System	6,445
8. Interest	6,095
9. Advertising, Entertainment, etc.	5,807
10. Pension	5,142
Total Adjustments	$ 248,667
Costs Recommended For Acceptance	$6,906,374

Note: Explanation of each adjustment is provided in the **"Findings and Recommendations"** section Of this rePort .

EXHIBIT D

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1989 THROUGH SEPTEMBER 30, 1990

Operation	Administrative costs
Claims Payment	$ 8,903,093
Reviews and Hearings	918,793
Beneficiary/Physician Inquiry	1,807,878
Professional Relations	397,659
Medical and Utilization Review	2,099,665
Medicare Secondary Payer	359,467
Participating Physician	424,394
Productivity Investments	183,569
Other	86,600
Total Administrative Costs Claimed	$15,181,118
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 537, 975
2. Executive Salary Increases	27,612
3. Professional Consultants	17,305
4. Deferred Compensation	12,461
5. Return on Investments	11,720
6. Automobile	9, 952
7. Indirect Cost Allocation System	6,986
8. Interest	6,767
9. Advertising, Entertainment, etc.	6,293
10. Pension	5,574
Total Adjustments	642,645
Costs Recommended For Acceptance	$14,538,473

Note: Explanation of each adjustment is provided in the " Findings and Recommendations" section Of this report .

EXHIBIT E

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1990 THROUGH SEPTEMBER 30, 1991

Operation	Administrative costs
Bills Payment	$3,443,218
Reconsideration and Hearings	143,634
Medicare Secondary Payer	568,605
Medical and Utilization Review	302,198
Provider Desk Review	1,102,228
Provider Field Audits	659,405
Provider Settlements	453,407
Provider Reimbursements	556,155
Productivity Investments	120,255
Total Administrative Cost's Claimed	$7,349,105
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 125,604
2. Executive Salary Increases	38,272
3. Pension	37,679
4. Professional Consultants	31,469
5. Return on Investments	23,187
6. Deferred Compensation	22,455
7. Interest	17,816
8. Indirect Cost Allocation System	12,323
9. Automobile	5,239
10. Advertising, Entertainment, etc.	3,157
Total Adjustments	317,201
Costs Recommended For Acceptance	$7,031,904

Note: Explanation of each adjustment is provided in the **"Findings and Recommendations"** section Of this report.

EXHIBIT F

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1990 THROUGH SEPTEMBER 30, 1991

Operation	Administrative costs
Claims Payment	$10,095,362
Reviews and Hearings	1,141,551
Beneficiary/Physician Inquiry	1,839,219
Professional Relations	341,683
Medical and Utilization Review	2,315,461
Medicare Secondary Payer	464,294
Participating Physician	419, 177
Productivity Investments	399,727
Other	100,500
Total Administrative Costs Claimed	$17,116,974
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 437,898
2. Executive Salary Increases	51,382
3. Pension	40,904
4. Professional Consultants	34,163
5. Return on Investments	27,611
6. Deferred Compensation	24,378
7. Interest	19,342
8. Indirect Cost Allocation System	13,375
9. Automobile	6,887
10. Advertising, Entertainment, etc.	3,064
Total Adjustments	659,004
Costs Recommended For Acceptance	$16,457,970

Note: Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

EXHIBIT G

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1991 THROUGH SEPTEMBER 30, 1992

Operation	Administrative costs
Bills Payment	$3,468,501
Reconsideration and Hearings	326,246
Medicare Secondary Payer	690,791
Medical and Utilization Review	418,230
Provider Desk Review	1,038,115
Provider Field Audits	827,999
Provider Settlements	408,851
Provider Reimbursements	544,904
Productivity Investments	248,440
Total Administrative Costs Claimed	$7,972,077
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 111,440
2. Executive Salary Increases	85,972
3. Indirect Cost Allocation System	50,956
4. Pension	38,171
5. Deferred Compensation	25,860
6. Return on Investments	10,962
7. Professional Consultants	8,977
8. Automobile	4,436
9. Advertising, Entertainment, etc.	2,409
Total Adjustments	339,183
Costs Recommended For Acceptance	$7,632,894

Note: Explanation of each adjustment is provided in the "Findings and Recommendations" section of this report.

EXHIBIT H

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1991 THROUGH SEPTEMBER 30, 1992

Operation	Administrative costs
Claims Payment	$10,508,405
Reviews and Hearings	1,440,761
Beneficiary/Physician Inquiry	2,106,134
Professional Relations	309,229
Medical and Utilization Review	2,251,704
Medicare Secondary Payer	475,739
Participating Physician	370,344
Productivity Investments	911,484
Other	131,000
Total Administrative Costs Claimed	$18,504,800
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 457,608
2. Executive Salary Increases	110,132
3. Indirect Cost Allocation System	56,190
4. Pension	41,678
5. Deferred Compensation	28,235
6. Professional Consultants	9, 952
7. Automobile	7,530
8. Advertising, Entertainment, etc.	2,630
9. Return on Investments	(26,293')
Total Adjustments	687, 662
Costs Recommended For Acceptance	$17,817,138

Note: Explanation of each adjustment is provided in the **"Findings and Recommendations"** section Of this repOrt .

EXHIBIT I

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART A)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1992 THROUGH SEPTEMBER 30, 1993

Operation	Administrative costs
Bills Payment	$3,689,369
Reconsideration and Hearings	284,825
Medicare Secondary Payer	660,779
Medical and Utilization Review	467,819
Provider Desk Review	1,003,003
Provider Field Audits	1,222,827
Provider Settlements	441,281
Provider Reimbursements	569,191
Productivity Investments	173,342
Fraud and Abuse	69,417
Other	57,850
Total Administrative Costs Claimed	$8,639,703
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 104,878
2. Pension	68,974
3. Executive Salary Increases	61,228
4. Post-Retirement Health Insurance	27,051
5. Professional Consultants	24,520
6. Deferred Compensation	22,014
7. Return on Investments	18,383
8. Indirect Cost Allocation System	7,511
9. Automobile	4,584
10. Advertising, Entertainment, etc.	1,186
11. Taxes	274
12. Interest	(508)
Total Adjustments	340,095
Costs Recommended For Acceptance	$8,299,608

Note : Explanation of each adjustment is provided in the **"Findings and Recommendations"** section of this report.

ASSOCIATED INSURANCE COMPANIES, INC.
FINAL ADMINISTRATIVE COST PROPOSAL (PART B)
AND THE OIG RECOMMENDATIONS
OCTOBER 1, 1992 THROUGH SEPTEMBER 30, 1993

Operation	Administrative costs
Claims Payment	$11,041,966
Reviews and Hearings	1,654,325
Beneficiary/Physician Inquiry	2,281,910
Professional Relations	441,224
Medical and Utilization Review	2,048,015
Medicare Secondary Payer	525,396
Participating Physician	375,234
Productivity Investments	3,668,645
Fraud and Abuse	463,138
Other	280,081
Total Administrative Costs Claimed	$22,779,934
Recommended Adjustments:	
1. Complementary Insurance Credits	$ 476,460
2. Executive Salary Increases	83,115
3. Pension	76,255
4. Post-Retirement Health Insurance	29,907
5. Professional Consultants	27,120
6. Deferred Compensation	24,337
7. Automobile	9,070
8. Indirect Cost Allocation System	8,365
9. Advertising, Entertainment, etc.	1,694
10. Taxes	772
11. Interest	(32)
12. Return on Investments	(16,888)
Total Adjustments	720,175
Costs Recommended For Acceptance	.$22,059,759

Note: Explanation of each adjustment is provided in the "**Findings** and Recommendations" section Of this repOrt.

APPENDI

AdminaStar Federal — Medicare

a subsidiary of Associated Insurance Companies. inc.

Provider Audit & Reimbursement/Finance

November 15, 1995

Mr. Rick Pound
HHS/OIG Office of Audit Services
575 North Pennsylvania Street, Room 680
Indianapolis, IN 46204

RE: Draft Audit Report
FY 1990-1993 Medicare FACP'S

Dear Mr. Pound:

In response to the letter from Paul 'Swanson dated September 14, 1995, we have prepared the attached responses to the adjustments included in your draft audit report for Fiscal Years 1990-1993.

Our response includes narrative information for each adjustment issue and, where appropriate, copies of internal documents that further clarify our positions. We appreciate your review and consideration of our comments prior to finalization of the Audit Report.

We also look forward to the formal exit conference as an opportunity to amplify our responses and answer any questions your staff has about the responses and attachments.

If you have questions or need additional information, please contact Peg Rusterholz or myself

Sincerely,

Dennis W. Brinker

Dennis W. Brinker, CPA
Chief Financial Officer and Vice President of
Intermediary Operations

DWB/pml

cc: S. Crickmore
D. Dominick
A. Goad
P. Rusterholz
B. Toiler

Complemental Insurance Credits

After review of the draft audit adjustment and supporting workpapers, we remain convinced that our original complementary insurance credit rates used in the preparation of the FY 1990-1993 FACP's are reasonably computed in accordance with Section 1601 of the Medicare Intermediary Manual. This manual section had been in place since the original effective date of May 16, 1986 without any modification or clarification by HCFA. Since 1986, HCFA has not performed an audit of the complementary coverage methodology or questioned the actual rates used in any fashion. On the FY 1987-1989 FACP audit, another method was used but those adjustments were not proposed until well into FY 1993. We do strongly disagree with the proposed 1987-1989 adjustments for the same reasons we present in this response.

HCFA Program Memorandum AB-95- 1, issued in January, 1995, does institute fixed complementary coverage rates effective January 1, 1995 and includes the general methodology used in developing those rates. Review of AB-95- 1 provides no indication that HCFA intends for that methodology to be applied retroactively to the audit of open FACP'S and does not appear to serve as a clarification of previously issued manual instructions. It is also clear that HCFA only used this approach as a guide in determining the fixed rates that were implemented in January, 1995. The bulletin indicates that the lowest cost per claim of all FI's and Carriers was used as the final rate. HCFA would, in our opinion, not have selected the absolute lowest rate if they believed the methodology was completely appropriate. We also cannot understand how use of the lowest FI in the nation could produce a $.69 per claim rate for Part A when the audit workpapers reflect an $.835 rate for Indiana for FY 1993. Over the last few years, Indiana has been one of the lowest, if not the lowest, cost contractor for Part A

We believe that our approach to the calculation which is primarily based on Line 1 Claims Processing costs is a reasonable and supportable interpretation of Section 1601 of the Intermediary Manual. It is inappropriate to retroactively adjust a good faith effort on our part to compute a reasonable rate without any change in the manual instructions.

The following additional comments relate more specifically to the cost elements included in the audit calculation of the complementary coverage rate:

1. Medicare Secondary Payor

   In general, the complementary insurance policy is designed to cover only the deductibles and coinsurance which the Medicare program deducts from its final payment. The complementary insurer knows the beneficiaries who have its coverage and is just interested in receiving basic claims information from us for its insureds. The prepayment MSP analysis done for Medicare claims is basically unrelated to the development of the complement insurance record and of no value to the insurer, Claims for which Medicare is a secondary payor will likely never go to a complementary insurer since the beneficiary in question has primary coverage, not complementary coverage. MSP is applicable to Employee Group Health Plans with 20 or more employees. Traditional complementary or Medicare Supplement insurance is only for individuals. Indiana law prohibits MSP or subrogation in individual insured insurance policies. MSP costs should be removed from the total to compute an appropriate wst per claim.

2. Recons and Hearings

Cost included on these lines relate to the Medicare mandated appeals process providers and beneficiaries can undertake if dissatisfied with an original claim payment. These costs are postpayment and thus unrelated to the development of the original complementary insurance record. If in any type of appeal the original is upheld, the complemental insurer will never see any information or liability related to the appeal resolution. If an appeal decision results in an adjustment to the original payment and the adjustment is crossover, the complementary insurer will be required to pay the established rate a second time. In general, we do not believe that the language in Section 1601 covers Recons & Hearings costs as supporting the contractor's claims processing activity.

3. Inquiries

One half of the total costs of this Part B operation are included in the complementary coverage rate calculation. Medicare instructions mandate a significant effort to handle inquiries by providers and beneficiaries. Obviously some portion of inquiries received relate to claim status, but we question the inclusion of this operation in the calculation. The written or telephone inquiries request information on action taken by our Medicare staff, the payment and/or denial of Medicare benefits, and has no relevance to any subsequent activity taken by another company or insurer. In our opinion, the relationship of the inquiry function to the claims processing activity is not sufficient to support charging the ' 'complementary insurer based on the language in Section 1601. There is no reason to relate value and cost for this service to other than Medicare beneficiaries and providers.

4. Medical Review Costs

Though a prepayment medical review can be a part of paying a claim, we believe it is a Medicare specific function not appropriate for inclusion in costs for the rate calculation. The original manual section used in developing the rates gives no clear indication that Medical Review costs should be a part of the complementary rate calculation.

5. Other Costs

The audit rate calculation excludes Postage costs as indicated in AB-95-1. In our opinion, several other cost elements included in reported costs should be backed out as unrelated to the development of a complementary insurance record. Additional items include:

a. Mail handling costs not included in Postage Expense on the FACP.

b. Provider education and training costs included in Part A claims processing costs.

c. Printing costs, especially those related to the printing of provider remittances and Explanation of Medicare Benefits that are not applicable to the complementary claim transfers.

d. Microfilm, microfiche and record retention costs applicable only to Medicare.

e. Return on Investment which is a specific Medicare add-on to reported costs, not a cost itself

f. Indiana Gross Income Tax since the credits received from complementary insurers actually serve to reduce this revenue based tax.

g. Certain other Medicare specific costs like our Government Programs area which are more indirect cost items specifically related to Medicare requirements.

6. We question whether Part B complementary claims transfers to external companies (other than AICI) should be included in the adjustment calculation. Contracts negotiated with external companies set the rate to be charged per claim. Since the contract controls rates of payment, all monies received were offset against expenses on the FACP, and there is no mechanism for collecting more, rates should be considered final without adjustment.

In summary, the complementary credit rates used in these fiscal years are based on actual costs and are reasonable in relation to existing manual instructions at the time. A good faith effort to follow the limited instructions available should not be retroactively adjusted based upon a 1995 instruction that only supports a fixed rate for the future.

Executive Salary Increases

After review of this adjustment to reported costs and the supporting documentation provided, we contend that the adjustment to executive compensation is inappropriate and should be reversed.

Though we certainly agree that expenses reported on our Medicare contracts should be reasonable, the Medicare contract and FAR regulations do not support the review methodology used in developing this adjustment. FAR Section 31.201-3(a) identified in the Draft Audit Report appears to relate more appropriately to other expense items, not salaries. Section 31.205-6 also covers Compensation for Personal Semites but again does not support the arbitrary establishment of a base period with application of prescribed increase percentages. Retroactive application of a standard not communicated to contractors in anyway is inappropriate.

Additional comments related more specifically to Associated Insurance Companies, Inc. (AICI) and its executive compensation practices are detailed below.

1. The period under audit (including the base year selected) was a period of massive change and expansion for AICI. The size and nature of our corporation was changing dramatically and the roles and responsibilities of upper management were expanding accordingly. Many of these changes were in planning or just being initiated in 1989 which makes 1989 very questionable as an appropriate base year. AICI total revenues are an example of the amount of change. In 1988, total revenues were approximately $.9 billion, in 1993 the corporation produced $3.4 billion in revenue.

2. With the total corporate reorganization and expansion during the base year and audit period, corporate office staff Medicare allocation percentages were actually being reduced. Reductions are particularly evident in the later years under audit. In effect, the actual allocation of cost to Medicare did not increase in proportion to the increase in compensation.

3. Annual Incentive Plan payments to the executives included in your analysis were used in your computation of allowable compensation. At AICI, incentives are earned based upon meeting specific corporate, departmental, and individual targets and thus are not consistent in amount by year. Incentive eligibility thresholds also changed over this period in time with the responsibility expansion noted above. Incentive payments are certainly a part of total compensation, but we question whether the Bureau of Labor Statistics information used in your analysis consider incentives at all. The schedule indicates that it covers wages and salaries only.

4. The reasonableness of total costs reported to Medicare during the years under audit is also of note in a discussion of reasonable compensation. During these years, our Part A costs per claim have been among the lowest, if not the lowest, of all contractors. Part B cats were also extremely competitive during this period. Reductions in corporate overhead allocations to Medicare have been a factor in these positive results. The corporate and Medicare specific executives included in your analysis have been instrumental in establishing the structures and practices that produce reduced operating costs.

5. More specific examples of organizational changes affecting your test of the reasonableness of executive compensation are detailed as follows:

   a. S. Crickmore - CEO of AdminaStar Federal - Before August 1, 1989, Steve was Director of Part A Operations only. At that point, he became Executive Director of all of Medicare Operations. With this new position also came a higher incentive threshold. The incentive payment and 11 months of the compensation in your base year analysis relate to his Part A position. Thus, FY 1989 is not appropriate as a base year for reviewing the years under audit. Additionally, Steve did not assume the expanded CEO responsibility until FY 1992 when AdminaStar Federal became a separate legal entity.

   b. B. Lytle - CEO of AICI - Mr. Lytle did not officially become CEO until March, 1989 when the previous CEO retired. Thus the FY 1989 compensation used in your analysis relates in part to his previous position. As for Mr. Crickmore, the entire incentive paid to Mr. Lytle in 1989 relates to his previous position. For these reasons, FY 1989 is not an appropriate base year.

   c. Review of the base year accumulations for several other of the executives analyzed, including Mr. Rosenberg Mr. Sheridan, Mr. Trigg, and Mr. O'Connor indicate significant salary increases at January, 1989 separate from merit increases given later in the year. Preliminary analysis and discussions indicate that these increases do relate to changes in title and responsibility. Mr. Trigg , for example, in 1989 moved from Vice President and Assistant General Counsel to Senior Vice President and General Counsel. With the salary changes and expanded incentive eligibility, it again appears that FY 1989 is not a representative base year for the years under audit.

   d. Mr. Rosenberg's title and functional responsibility changed again in FY 1991 with the establishment of AdminaStar, Inc. and his expanded role as CEO of that company.

In summary, we propose that the entire adjustment to Executive Salary Increases be eliminated due to lack of specific regulation support and the information presented regarding organizational and position changes occurring at AICI during the base year and audit periods.

Pension Costs

The pension cost adjustment covers several issues. The following response deals with each of those items individually.

1. Employee Pension Plan Accrual

   We agree that employee pension plan expenses were not funded through cash contribution during the fiscal years in question. The pension plan had previously become overfunded as documented by our actuarial reports and thus no actual finding was required. We accept this portion of the adjustment.

2. Non-Medicare Costs/Duplicate Accruals '

   The duplicate accruals issue relates to December, 1991 expense accruals for fees due to William Mercer & Co. and Wyatt& Co. for pension services. The attached microfiche copies demonstrate that in December, 1991 we accrued these expenses and credited Accounts Payable. In January, 1992 the invoices were actually paid and charged against the payable recorded in December. The payments were not charged to expenses a second time, thus no duplication exists. We request that the adjustment of $1,136 to our Medicare costs be eliminated.

   We accept the $1,198 adjustment for costs unrelated to Medicare. This item includes several small corporate office expenses that did relate to pension but were unrelated to Medicare.

3. Supplemental Employee Retirement Plan (SERP)

   The SERP program is a Deferred Compensation plan that was established just for the most highly compensated employees whose participation in the employee pension plan was limited due to the level of compensation.

   In general, a pension plan is one form of a deferred compensation plan. Pension plans have their own set of accounting and cost allocability rules and regulations that do not necessarily apply to other types of deferred compensation plans. Sections 30.415 and 31.205-6(k) of the Federal Acquisition Regulations cover accounting for deferred compensation plans. Neither section indicates that deferred compensation expenses must be funded to be allowable expenses. Our response to the Deferred Compensation FACP adjustment provides additional information as to our rationale on this issue.

We also note that in previous FACP audits the SERP costs were not totally disallowed based on lack of tiding. The auditor did specifically review the SERP plan and did make a partial disallowance to attempt to discount the accruals for the upper level deferred compensation program **(SERP)** to present value. The application of present value to compute allowable cost is revered in Section 30.415.40(b) of FAR

In summary the total $25,989 adjustment to SERP **costs** should be recalculated in accordance with FAR Section 30.415.

Deferred Compensation

The audit adjustment removes expenses charged to Medicare in relation to the Deferred Compensation plan established for "highly compensated" employees and insurance premiums paid on life insurance policies purchased to build cash surrender value and thus provide security to the participants in the plan. The adjustment is based on Regulation Section 31.205-6(j)(l) which requires that pension costs must befunded to be allowable for cost reimbursement.

The AICI Deferred Compensation is a "non-qualified" plan established to provide higher paid employees the opportunity to take advantage of income deferrals and company matching to the extent available to all other employees through the established 401(k) plan. 401(k) participation is limited by law once a certain level of compensation is reached. One of the requirements of an unqualified Deferred Compensation plan to achieve tax benefits is that it not be funded in anyway. Income deferred by participants becomes a part of the company's general assets and the participants are only general unsecured creditors of the company.

Interest due employees on their amounts deferred is also booked as expense by the company. The corporation also has chosen to purchase life insurance policies on the deferred compensation participants. Though the corporation is the beneficiary on the policies, the cash surrender value accumulated provides informal additional security to employees.

The preceding paragraphs provide general information regarding the workings of our Deferred Compensation Plan. Our comments regarding the specific adjustment areas follows:

1. Executive Life Insurance Expense

   We have one technical comment regarding the calculation of the Insurance Expense adjustment for FY 1993. Your adjustment deals only with the Medicare allocated share of the December, 1992 premium payment to Pacific Mutual. When premium payments are made, a share of the payment is charged to expense and the remainder to an asset account for the Cash Surrender Value on the policies, In December, 1992, periodic reviews of the Cash Surrender Value wereperformed which resulted in journal entries revising the asset balance and accordingly Executive Life Insurance Expense.

   Four of these reviews were done in FY 1993 with corresponding journal entries (copies attached) which in total reduced the insurance expense by $357,284. Since these entries represent, in effect, adjustments to previously recorded premiums, they should be considered in your analysis. Including these entries should reduce your adjustment to the $5,181 amount claimed for FY 1993 on your workpaper. This change will reduce the Medicare adjustment for FY 1993 by $19,817.

We do also question the complete disallowance of Executive **Life** Insurance payments. The expenses charged to this account are actual payments to an insurance company for life insurance policies. The policies do provide a measure of security for both the **company** and the deferred compensation participants. Only premium payments in excess of the increase in cash surrender value is charged as an expense. The regulation section on pension **funding** mentioned does not, in our **opinion,** support denial of this expense item.

2. Executive Deferred Compensation Expense

Included in this account are basically expenses for the company match on amounts deferred by plan participants and interest accruals on total company liabilities to participants.

We agree that the amounts expensed are not **funded** since **funding** is not allowed for an unqualified plan. Our review of **applicable** regulations indicates that a Pension Plan is one form of a deferred compensation plan. Pension plans have detailed regulations **covering** accounting and cost allocability **that,** in our **opinion,** do not necessary apply to other types of Deferred Compensation plans. Sections 30.415 and 3 l-205-6(k) of the Federal Acquisition Regulations cover **accounting** for deferred compensation plans. These sections do not contain the **funding** requirements that are applicable to pension plans. Section 30.415-20(b) reads that "This standard is applicable to the cost of **all** deferred compensation except for compensated personal absences and pension plan costs which are covered in other Cost Accounting Standards".

In **general,** expenses recorded and interest accrued are liabilities of the corporation at the time they are recorded. Ifa plan participant **leaves** the company at any time, the company is liable for **all** deferrals and accumulated interest. The stated interest rate in the plan is less **if an** employee does not remain with the company until retirement. Section 30.41 5-40(b) does indicate that amount of **deferred** compensation claimed shall be the present value of the **future** benefits to be paid. Section 30.415-50(d) indicates that interest expense is an allowable component of deferred compensation costs.

Based upon this analysis and supporting regulations, we propose that the deferred compensation **costs** in question are allowable and allocable to Medicare along with applicable interest expense with the application of present value concepts.

Professional Consultants

In total, this adjustment is broken down into four categories in the audit workpapers. For ease of explanations, **our** comments are organized **in** the same **fashion**.

1. Excluded Accounts

We accept the adjustments in this category with only the following proposed changes.

& Legal **Services** Non-Government - Account811 025

FY 1990 -We have been unable to **identify** the $616 direct cost noted in the auditor's report. Attached are copies of the GL at October, 1989 and December, 1989 which reflect no activity in the 1989 account number 75002 for a Medicare direct cost center. Also attached is a copy of Company 2007's Trial Balance as of September 30, 1990 which also does not show expense in account 811025, The $616 **finding** should be reversed.

b. **FY** 1992 and 1993- The **JV** "adjustments" noted on the auditor's workpaper ($ 16,495, $2,414 and $425) were adjustments to Medicare A and B at the rate of **100%**. Nothing was removed for a Common Audit **allocation,** thus, the adjustment should not do so either. As documentation we have attached copies of the GL to FACP reconciliations which will reflect the amounts at 10OO/O.

2. **Personal** Services

This audit finding disallows payments which result infringe benefits to high-level corporate executives. The provision of these benefits is established corporate policy. The invoices themselves are payments of services for individual tax preparation fees, investment **advice,** and estate **planning, all** of which are offered to high-level **corporate** executives as a benefit of their position with the company. Concerning allowability, we reference FAR Part 3 1.205-6(m)(l). The entire finding of $22,629 should be reversed.

3. unsupported costs

We **accept** the adjustments in this category with only the following proposed changes.

$889 of the finding is a duplication of expense denied within the auditor's judgment of Non-Medicare Costs. Specifically, Ernst& Young invoice dated Ikcember31, 1992 for $12,225 with a Medicare share of $889 is also listed under the denials for Ernst & Young, CPA Firm, audit workpaper M-4/7.

Additionally, we would ask that the J. McKelvey expense of December 31, 1992 for $28,800 be allowed. Jim McKelvey was not an outside vendor but was an employee hired by the company as a systems programmer. As an employee of the corporate office financial systems cost center, he was often assigned to perform special programming tasks for other areas. It was customary for his time to be charged to whatever cost center for which he was providing services. In the case of this journal entry, the cost center was 3310, Anthem Controllers Division Administration. While the original documentation has not been located, we can reasonably assume that this must have been a financial systems related service charge for Mr. McKeIvey. It was most likely the cost related to his design and implementation of the corporate budget system. We propose that the Medicare share of this item which totals $2,059 be allowed as reasonable.

4. Consultant Expenses Unrelated to Medicare

We accept this portion of the adjustment in total.

In summary, we note that the accepted adjustments relate to corporate office consulting invoices from cost centers allocating small percentages of cost to Medicare and not Medicare direct areas. We will attempt to monitor these allocations more closely in the future.

Indirect Cost Allocations

This finding included adjustments in three separate areas which are identified as follows:

1. Non-Deferred Comp. costs in Account 0805045
2. Excluded Account Allocation
3. Corporate Office Cost Center Allocations

Our response to each issue are detailed below:

1. Non-Deferred Comp. Costs

   a. FY 1990

      The only adjustment for FY 1990 involves a November, 1989 journal entry of $74,867 for Errors and Omissions Insurance charged to the Executive Life Insurance account in the Executive Benefits cost center. Our review of this entry identified a December, 1989 entry that reclassed the amount in total out of Executive Benefits to the Corporate Services Administration cost center where this type of insurance expense is normally located. Attached are microfiche general ledger copies which document the original entry and the subsequent reclassification.

      Since Errors and Omissions Insurance is a normal cost of business for a corporation and reasonably allocable in part to Medicare and since the expense was reclassed to the proper cost center, this adjustment totaling $8,298 should be eliminated.

   b. FY 1991

      The adjustment here relates to two journal entries in April, 1991 that "allocate miscellaneous expenses" to Account 805045 in cost center 0111, Executive Benefits. Further review of these entries indicated that they were reclasses from Cost Center3216 in the Home Office - Mutual. As you know, Executive Benefit expenses were recorded in Cost Center 3216 prior to the creation of a separate Corporate Office inCalendar Year 1991. In this case, the monthly deferred compensation related entries continued to be posted to Cost Center 3216 until April, 1991 when the error was identified. At that point, accumulated expenses charged through April were reclassified to Cost CenterO111 in the Corporate Office. Attached are microfiche copies which document the reclassification.

The $82,925 balance in Cost Center 3216 is broken down as follows:

Def. Comp. Interest Accrual	$31,349
Def. Comp. Alt. Co. Match	27,899
Def. Comp. Rest. Co. Match	23.677
Total	$82.925

These expenses should, therefore, be a part of your Deferred Compensation analysis and adjustment. Our rationale as to the allowability of Deferred Compensation costs claimed is explained in our response to the Deferred Compensation issue.

c. FY 1992

The remaining adjustment to FY 1992 relates to monthly fee for services charges to Account 805045 in Cost Center 0112 which began in January, 1992. Our research indicates that these monthly entries represent charges from the Mutual (Company 2001) to the Corporate Office covering the costs of the Human Resources Information System (I-IRIS). As the attached memos explain the HRIS staff remained a part of Anthem in 1992 due to a management decision not to break up a unit while some other projects were ongoing. Since the HRIS staff was performing Human Resources functions for the entire company, applicable costs were routinely transferred to the Corporate Office through the fee for service process. This fiction did serve AdminaStar Federal, therefore a cost allocation to Medicare through AdminaStar Federal is appropriate.

We cannot explain why the fee for service was charged to Account 805045, Executive Benefit Expense, as this group did not work only with executives. Regardless, the function does benefit Medicare and the adjustment should be reversed.

Also attached for your review are copies of journal entries recording this expense on Corporate Office books and a General Ledger summary identifying corresponding credits to expenses for the Anthem Mutual company. The credits are larger than the expenses actually charged to the Corporate Office because they include other FFS items. Cost Center 3212 in the Anthem company stopped allocating cost to AdminaStar Federal in 1992 when this function was moved to the Corporate Office.

d. FY 1993

(1) For FY 1993 through January 1993, fee for service expenses identical to those explained above were part of your adjustment. Effective February 1, 1993, the HRIS staff was transferred to the Corporate Office and that FFS was no longer necessary. After that date the FFS charge covered only one Anthem employee who was being loaned to the Corporate Office. The accumulation of salary, benefits and other expenses produce the 1993 fee for service charge. The memos and general ledger schedules attached for FY 1992 also support the reduced 1993 charge. Again, this individual performed human resources functions for the entire corporation and a share of her expenses are properly allocated to Medicare. This portion of your FY 1993 adjustment should be reversed.

(2) Your FY 1993 adjustment also includes a $13,800 item in September, 1993. The attached memo from Peg Rusterholz dated September 3, 1993 explains the circumstances of this entry.

Throughout 1993 we had been receiving a management fee charge from the Corporate Office covering employees participating in the Deferred Compensation program. In September, we were informed that the direct charge was inappropriate since we received our allocation of the total expense through Corporate Office cost allocation. We proposed an adjustment to reclass the amount charged back to the Corporate Office. Basically what this entry becomes is a reduction to the management fee credits in Cost Center 0111. Since your deferred compensation adjustment deals with the deferred comp. expenses themselves and not the management fee credits, the $13,800 journal entry should not be a part of this adjustment.

(3) Another journal entry included in your FY 1993 adjustment is a December, 1992 entry to Cost Center 112, Account 805045, labeled correction of 1993 Employee Benefit Package. The total entry was for $88,454.

This entry was a correction of a November, 1992 posting which recorded the expense in an advertising account. When it was determined that the item in question was the materials developed for employees for the 1993 benefit enrollment, the expense was reclassed to the Employee Benefits cost center. The Executive Benefit account should not have been used since the item related to all employees, but it does appear to be an allocable expense.

Attached are microfiche copies documenting the original November, 1992 entry and the December, 1992 correction. The liability to AGGIC relates to the Dallas, Texas subsidiary of AICI that actually did the printing of these benefit materials.

(4) The final FY 1993 adjustment relates to entries related to Acordia credits made in December, 1992 and January, 1993. It appears this entry relates to the segregation of Acordia benefits that became necessary when Acordia became a public company. Attached is a copy of the journal entry supporting the amount in question. At this time, we have been unable to find additional supporting information.

2. Excluded Account Allocation

This portion of the Indirect Cost Allocation adjustment totals $23,844 for the four fiscal years and represents the disallowance of expense charged to Medicare from the expense accounts, Salaries - Sales Commissions and Penalties. Our response regarding each account follows:

a. Penalties (Account 817505)

We have been unable to identify any FY 1992 overhead allocations to Medicare from this account. As support for our position, we have attached the Trial Balances from AdminaStar, Inc. dated December31, 1991 and September 30, 1992 which do not reflect account 817505. Also attached are summaries (excluding manual journal entries) of Corporate Office and Anthem overhead allocations for FY 1992. The referenced account does not appear on the summary. The proposed $7,591 adjustment should be reversed as follows:

Medicare A	$7,591	X46.81%=	$3,553
Medicare B	$7,591	X 51.11%=	<u>$3,880</u>
Total			<u>$7,433</u>

We will accept the $562 adjustment noted in FY 1993,

b. Salaries - Sales Commissions (Account (804050)

(1) Direct Expenses

It appears that we were either consciously using this account as a "bonus and awards" account or the account included miscodings from the account 804040, Salaries- Bonuses & Awards. In summary, the direct expense items charged to this account are not sales commissions, but upon invoice review are allowable expenses related to employee or departmental awards or prizes. Invoices are attached for your review.

The entire amount identified as direct expense should be reversed ($2,497 A and B combined).

(2) Corporate Expenses

This account at the corporate office level has apparently been subject to the same types of invoice accumulations. On the basis of the following samples, we request that the entire overhead adjustment for this account be eliminated.

During February, 1990, Management Incentive Payments were made to Lloyd Banks and Richard Kilborn. The total $118,632 amount was incorrectly coded to the Sales Commission account 804050. (See documentation attached.)

Regarding FY 1991, we have attached two sample invoices which we reviewed. Notice that the Stivers Temporary Service while coded on the invoice to account 804020 was miskeyed to 804050. The Tryad Corporation invoice was for the purchase of engraved pens for employee anniversaries. Also, there appears to have been a keying error in the overhead summary report for FY 1991 in cost center 122. $2,520 was entered as the September year to date number in account 804050. It should have been keyed to account 805050.

For FY 1992, our summary workpapers reflect this account accumulation combined for Medicare A and B as follows (excluding Common Audit):

Cost Center 3330	$1,181
Cost Center 122	244
Cost Center 111	(418)
Cost Center 3212	(48)
	$959

Upon closer examination, it appears that our own summary workpapers contained some errors as neither Cost Center 3330 nor 122 had expense in account 804050.

On the basis of volume of these sampled items and the fact that none of the cost centers allocating expense to Medicare had any reason to incur Salaries - Sales Commission expense, we believe that this entire adjustment to corporate expense should be eliminated.

3. Corporate Office Cost Center Allocations

a. Cost Center 3700- Corporate Medical Director

This cost center was established in FY 1992 with the hiring of a Medical Director for all of AICI operations. Throughout Fiscal Years 1992 and 1993, a share of the expenses for the Medical Director were allocated to AdminaStar Federal. Around the beginning of FY 1993, we began to question the allocability of this cost center to Medicare. Various consulting and coordination activities were identified in support of the allocation. We included the allocation in reported expenses for the FY 1992 FACP but understanding some of the differences in corporate and Medicare direction, we continued to question the allocation for FY 1993. In the end, we decided to exclude the allocation from Medicare reporting for FY 1993.

In summary, we believe the memo documentation provided during your audit does support some allocation to Medicare in FY 1992.

b. Cost Center 0101- Platinum Card Project

After the FY 1992 FACP had been submitted, it was determined that this cost center should not have had an allocation to AdminaStar Federal. When the correction to eliminate the allocation was made, it was charged to FY 1993. We accept the audit adjustment to offset this credit against the appropriate fiscal year.

c. Cost Center 0165- Corporate Affairs

This cost center was formed in mid-1991 and allocated to Medicare through December, 1992. Review of the Cost Center Profile and the response to questions received from the cost center head support the appropriateness of an allocation to Medicare. We cannot determine why the allocation to Medicare was discontinued at January 1, 1993.

Regardless of the treatment in 1993, we believe an allocation of this mst center to Medicare for the periods in question is reasonable.

d. Vice President and Chief Investment Officer

We accept this adjustment.

Return on Investment

This adjustment includes both audit changes to the fixed asset values used in the Return On Investment (ROI) calculation and changes to the investment rates of return applied to those asset values. The following comments address each issue individually.

1. Fixed Assets

   We accept the adjustments to specific asset valuations for the ROI computation.

2. Investment Rates of Return Used

   For several years, our method of calculating the Medicare Return on Investment has involved acquiring a copy of AICI's Consolidated Yield on Invested Assets calculation and converting that from a calendar to fiscal year basis. We have placed reliance on the corporate offices' rate calculations which only reflect summary level investment information. While the auditors were on-site, we were unable to obtain copies of the AICI consolidated trial balances which were used to produce the rates. Since. the audit field work has been completed, consolidated trial balances have been located. When we obtained the trial balance information, we chose one month from each year and reconciled investment asset and income balances from the trial balance to our ROI schedules. A few variances exist, but as tested, they have an immaterial effect on the rates themselves.

   Attached are our worksheets reflecting the conversion of the calendar ROI rates to the fiscal year basis for each year. Also attached are copies of the calendar year yield information originally supplied by corporate office and copies of the consolidated trial balance for each year and reconciliation schedules we prepared. For 1992 and 1993, there are also copies of detailed (by company) trial balances which must be used because some of AICI's subsidiary companies have been backed out to reflect only the core insurance business. Data for additional months can be obtained upon request.

In summary, we are asking that you accept our rates of return as originally calculated and apply them to the net book values of the cost centers that the proposed audit adjustment appropriately identified.

Post Retirement Health Insurance

We agree that the FASB 106 expenses included in the FACP were not funded by AICI as required for Medicare allowability. FY 1993 was the first year that these expenses were recorded on an accrual basis by AICI and we did not follow-up to determine whether we planned to fund the expense.

As was discussed during the FACP audit, AICI chose to continue the "pay as you go" approach to Post Retirement Health Benefits and made a substantial amount of health claim payments for retirees out of general operating funds. Prior to the FASB change, these payments would have been recorded as expense; in 1993 they were treated as offsets against the FASB liability setup with the expense accruals.

Your net adjustment for FASB 106 does take into account, to a certain extent, the actual payments made for retiree health claims. The attached schedule reconciles to the General Ledger and documents actual retiree claim payments and premiums received. It is our position that the same employee headcount percentages used to allocate the reported FASB 106 expense accruals to Medicare should be used to allocate the actual retiree payments. Headcount is a reasonable allocation basis for benefit expenses and has been used historically to allocate these expenses prior to FASB 106. It is almost impossible to determine a specific allocation percentage for retiree payments. The schedule that we provided identifies retirees as of the retirement date when retirees actually worked in a variety of areas. Additionally, Shelby retirees are included in the allocation basis when Shelby retirees are excluded from both the FASB accrual and the actual payments.

The most significant issue is that AICI retirees include retirees from all areas before subsidiaries were created. AdminaStar, Inc. was started in 1991 and AdminaStar Federal in 1992. All Medicare staff who retired prior to 1992 are in the AICI count and quite a few can be easily identified on the AICI list of retirees. Other AICI retirees worked in Medicare at some point in their careers or performed Corporate Office functions that allocated a significant percentage to Medicare.

In summary, these facts support the use of active employee headcount as the allocation basis for actual retiree expenses and thus a substantial reduction in the FASB 106 adjustment.

Automobile Costs

This adjustment covers two areas of employee reimbursement. We will comment on each area separately.

1. Mileage Difference (Including ASC Reimbursement)

We have been unable to reconcile the auditor's account total listed for account 812030 (72209) for October - December, 1989. Audit workpaper L-7/6 reflects $18,168. We believe that the amount should be $4,096 for the three months and have attached a calendar year recipient report as support. This change will reduce the adjustment by $649 as shown on the attached schedule.

We do understand that mileage reimbursement is based on the Federal Travel Regulations. We had made an assumption that the federal rate would increase retroactively in accordance with the IRS approved rate. Once it was determined that the federal rate was not increasing, we froze our internal rate. We accept the remainder of this adjustment.

2. Car Allowances

As a fairly common industry practice, car allowances at AICI are considered part of an executive's total compensation package. The company clearly considers the allowances as compensation, the appearance of the amounts on the executive's earnings history is a testament to its intended compensation classification. We believe that it is not appropriate to consider this expense as an automobile expense and subject it to business mile recordkeeping requirements and travel rate limitations. The adjustment for executive automobiles totals $45,070 for the four years and should be reversed.

Though we believe the entire executive auto expense is allowable, we also mention that $1,297 of the total adjustment was to Cost Center 165 in Fiscal Years 1991, 1992 and 1993. The allocation of this cost center to Medicare was denied in another adjustment. This duplication needs to be corrected if the executive auto allowance adjustment and the denial of cost center 165 stand.

Interest CoSts

We agree that the **identified** Interest Costs on borrowings against the life insurance policy values are not allowable costs for Medicare reporting.

As the audit adjustment demonstrates, we took action starting in Fiscal Year 1992 to exclude this interest expense from costs reported to **HCFA**.

Advertising, Entertainment, Dues and Contributions

This adjustment relates to the denial of all expenses charged to Medicare through a number of expense accounts deemed unallowable per regulations. Our comments on these accounts and the appropriateness of the adjustment amounts are organized by fiscal year.

1. N 1990

a. Newspaper Ads ($2,976)

Review of general ledger postings to this account identified three entries in late 1989 from Medicare direct cost centers. These items total $645 and appear to be "help wanted" in nature rather than advertising for business. Sample copies of General Ledger pages are attached as support. The remainder of the expense is in Corporate Office cost centers and determination of the purpose of the add is more difficult.

We propose that $645 of the total adjustment to this account be reversed.

b. Other Ads ($637)

Two late 1989 entries make up this total. One$61 amount is in Cost Center 32530, Electronic Sales. In previous audits, advertisements in this cost center have been allowed since-their intent is to increase the number of claims filed electronically, a specific Medicare mandate. The $61 is only Medicare's allocated share of the total invoice. The remaining $576 relates to Cost Center 39000, Government Programs Administration. The service was performed by Juhl Advertising and the $576 is the Medicare share of the invoice payment. Juhl has prepared plaques for us to recognize areas exhibiting outstanding Medicare performance.

We propose that the entire $637 adjustment for this account be reversed.

c. Sales Promotion ($136)

We accept this adjustment.

d. **Entertainment** ($2,810)

Our review indicates that most of the expenses charged to this account were incurred in late 1989. Of the total $2,092 of the expenses were located in Government Division of Medicare direct cost centers. Attached General Ledger copies support $669 of payments to ARA Service in Cost Center 39000 with $468 of this total charged to Medicare. These expenses appear related to food services for employee meetings rather than non-allowable entertainment. Other Medicare direct cost center payments cannot be identified, but are likely allowable items.

We propose that the total adjustment be reduced by $468.

e. Blue Cross Dues (-$138) and Corporate Contributions ($3,033)

We accept these adjustments.

f. Blue Shield Dues ($6,034)

The attached General Ledger copies demonstrate that $3,720 of this total represents Medicare Dues charged 100°/0 to Medicare through Corporate Office Cost Center 10001. General AICI dues to BCBSA were located in a separate cost center and not allocated to Medicare.

The Medicare BSA dues have been treated previously as an allowable expense for HCFA reporting and should be so treated in this fiscal year. With the change in the corporate allocation system and cost center structure at January 1, 1990, the BSA Medicare Dues moved to Cost Center 3010 with only a small portion being allocated to Medicare. Medicaid related BSA dues are also in this account in 1990.

We propose that the allocation should be corrected for 1990 to charge the full amount of Medicare BSA dues to the Medicare program as follows:

Oct. - Dec. 1989 Allocation	$3,720
Jan. - Sept. G.L. Postings	16.155
Total	$19,875
Actual Allocated to Medicare	**(6,034)**
Increase	**$13,841**

In summary, the audit adjustment should involve a $13,841 increase to Medicare costs instead of a disallowance of $6,034.

g. Membership Dues and Other Dues (Total of $4,416)

Regulation 31.205-14 which is referenced in the finding does identify certain types of memberships as unallowable costs. On the other hand, Section 31.20543 identifies that membership in trade, business, technical and professional organizations are allowable expenses. Sample review of the General Ledger for these accounts demonstrates that both types of membership are included in our expenses.

The attached G/L page identifies a $107 expense in Medicare cost center 39510 for Hospital Financial Management Association (HFMA) membership. We propose that your adjustment be reduced by this amount.

2. FY 1991

a. We accept the adjustments related to Other Ads, Sales Promotion and Entertainment.

b, Membership Dues - Other Dues (Totals $3,707)

As noted in our FY 1990 response, certain types of membership dues are allowed by the regulations. In a sample review of G/L postings, we found that the $829 for Other Dues is Medicare's share of an invoice for National Association of Insurance Commissioners dues. A copy of the General Ledger page is attached. The group is a trade association covered under Section 31.20543.

We propose that the $829 adjustment to Other Dues be reversed.

c. Blue Shield Dues ($719)

The adjustment here relates to the October - December, 1990 effect of the same situation described in our FY 1990 response. Medicare specific dues are running through Cost Center 3010 and only a small percentage is allocated to Medicare. We made Medicare dues payments in October and November, 1990 totaling $3,600. (G/L copy attached.)

Actual Medicare Dues Paid	$3,600
Amount Allocated to Medicare	719
Additional Allocation	$2,881

We propose that the adjustment to this account should add $2,881 to expenses instead of eliminating $719.

d. Corporate Contributions ($40,81 8)

The FY 1991 summary of Corporate Office allocations prepared during the FACP audit includes $39,354 of contributions coming to Medicare through Cost Center 0110. Our review as supported by the attached General Ledger printout shows that through September, 1991, Cost Center 0110 did not incur any Corporate Contributions. Further review indicated that Account 840025, Miscellaneous Expense, was apparently coded as Contributions on the allocation summary.

We accept the remainder of the adjustment, but propose that it be reduced by the $39,354 explained above.

3. FY 1992

In general, we did note that several individual expense items denied through this adjustment relate to Cost Center 3700, Corporate Medical Director. Since that cost center was eliminated in total through another adjustment, there is a duplication. If the adjustment to eliminate the cost center stands, then this adjustment should be reduced by the following amounts:

Sales Promotion	$17
Entertainment	25
Membership Dues	177
Corp. Contributions	113
Total	**$332**

a. Newspaper Ads, Entertainment, Corp. Contributions

We accept these adjustments other than the correction for Cost Center 3700.

b. Membership Dues/Other Dues (Totaling $2,457)

As noted previously, allowable memberships maybe included in this total.

c. Sales Promotion#Novelty Giveaways (Totaling $16,208)

We accept the $1,990 adjustment related to Sales Promotions.

We have reviewed the General Ledger for the Corporate Office, Mutual, and AdminaStar, Inc. and cannot identify any Novelty Giveaways allocated to Medicare in this fiscal year. Perhaps an incorrect account was picked up in the accumulation of expenses.

We propose that the $14,218 adjustment for Novelty Giveaways be eliminated.

4. FY 1993

During review of supporting documentation we noted that allocations from Cost Centers 175 and 3700 were eliminated from expenses reported on the FY 1993 FACP's. We had received allocations from these cost centers during the year and expenses were included on the detailed by account summary on Medicare cost allocations.

It appears to us that expenses related to these cost centers are included in your accumulation of expenses. We propose that amounts related to these self-denied cost centers be excluded from your adjustment as follows:

Other Ads	$2
Entertainment	49
Membership Dues	113
Other Dues	2,640
Corp. Contributions	373
Total	$3,177

a. With application of the correction above, we accept the FY 1993 adjustments except for the $6,800 in Ads - Other. Almost all of the expense in this account relates to December, 1992 journal entries in Cost Center 112, Employee Benefits. (G/L copy attached.) The journal entries relate to a charge from Human Resources in the Anthem Mutual to the Corporate Office for services performed. We did check the Anthem General Ledger and verified that there were no amounts in account 809040 of this size in CY 1992. This supports our contention that this journal entry transferring cost to the corproate office was miscoded.

We propose that the $6,585 of Medicare allocation related to this item be eliminated from your adjustment.

Property Taxes

The item questioned here is a penalty paid due to a late payment of property taxes. We agree with this adjustment. The item was overlooked during preparation of the FACP.